Faculty of Economic and Business Administration Science

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The Impact of Soft Controls on the Effective Implementation of Internal Control Systems

أثر الرقابة الناعمة على كفاءة تطبيق أنظمة الرقابة الداخلية

This research is intended to cover the impact of soft controls on the effective implementation of internal control systems; it has the objectives of investigating and examining the level of awareness in soft controls and the perception of their importance, in addition to stand on the extent of implementation, and finally to investigate the limitation facing their effective implementation among the Jordan financial sector. This research differentiates itself in the following respects. First, the comprehensive coverage of soft controls aspects ranging from its definition, the relationship with hard controls and the entities specifics, to the discussion of soft risks and its relationship with corporate governance. Second, it provides detailed correlation and partial correlation analysis, in addition to spotting the differences between groups regarding certain control issues conducting multiple regression analysis in order to measure the prediction power of certain variables on the effective implementation of soft controls. Certain conclusions have been reached and recommendations have been made in order to boost the level of soft controls implementation level.

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"The impact of soft controls on the effective implementation of internal control systems"

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Table of Contents

Table of Contents

Table of Contents

List of Tables

List of Figures

List of Abbreviations

BOD	Board of directors
CEO	Chief executive officer
CoCo	Criteria of control framework
COSO	The committee of sponsoring organizations of the trade way committee
ERM	Enterprise risk management
GCC	Gulf cooperative counsil
HC	Hard controls
KRIs	Key risk indicators
SC	Soft controls
SMART	Specific, measurable, accountable, realistic, and timetabled
SOX	Sarbanes-Oxley act
VP	Vice president

Abstract

This research is intended to cover the effect of soft controls on the effective implementation of internal control systems; it has the objectives of investigating the level of awareness in soft controls, to examine the perception of their importance, to stand on the extent of their implementation, and to investigate the limitation facing their effective implementation among the Jordan financial sector. To reach these objectives, a questionnaire has been developed and distributed in order to collect the needed data for the sake of conducting the necessary analysis.

This research differentiates itself in the following respects. First, the comprehensive coverage of soft controls aspects ranging from its definition, the relationship with hard controls and the entities specifics, to the discussion of soft risks and its relationship with corporate governance. Second, it provides detailed correlation and partial correlation analysis, in addition to spotting the differences between groups regarding certain control issues conducting multiple regression analysis in order to measure the prediction power of certain variables on the effective implementation of soft controls.

The research concluded that the level of perception and implementation of soft controls in the Jordan banking sector is satisfactory except for a few discussion points that need to be addressed further. As a result several recommendation have been provided with respect to the need for exerting more efforts in terms of training, enhancing the transparency, unleash the personal and constructive control initiatives, resolve the issues limitations facing the effective implementation of soft controls, and finally calling for more involvement from the central bank in the process of implementing soft controls.

Chapter One

Introduction

Table of Contents

1.1. Overview

Michael Jensen's, 1993 affirmation that *making the internal control systems of entities work is the major challenge that economists and management scholars are facing*, and perhaps more than ever, at the heart of the recent evolution of internal control concepts.

Internal control can be defined according to the Committee of Sponsoring Organizations of the Treadway Commission COSO (Executive Summary, May 2013, page 3) "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance". In fact, the overall level of control has frequently proved insufficient, especially in the case of fraud acts which have negatively affected the financial and non-financial systems globally (appendix 1 shows a non-inclusive list of collapses in the financial system). Undoubtedly new financial shocks will occur.

Having an organization under 'control' and being accountable to investors is not only a clear well of the management, but it is also an identified request of internal control frameworks as well as a legal expectation, for instance Sarbanes-Oxley Act (issued in reaction to Enron) and many other laws operating locally and cross-borders. For nearly a century, legislators have systematically been trying to impose numerous regulations in order to respond to the scandals originating from the discovery of frauds and to reassure investors' interests – from the Foreign Corrupt Practices Act to COSO, from the Sarbanes-Oxley Act to the implementation of the European Directives and the recommendations of the EU Commission (Green Paper on Auditing, 2010) – such regulations are imposed to regulate the life of entities in a general manner, as well as the financial and accounting professions, especially in the aftermath of crisis moments, this proves that legislators are working on consecutive levels of oppression to achieve an ideal of universal control. These various laws and regulations, which led to the implementation of new formal controls, invariably resulted from the history of the scandals, reflecting a good willing to improve entity management.
No entity can expect to ensure its continuity without sufficient investment in internal controls. The fact that these internal controls are essential does not mean that they are effective enough, since each of us has the feeling that the formal control firewall is powerless against the breakdowns and breaches to internal control procedures. Furthermore, it is clear that nothing, at least for the moment, has enabled entities to completely restrain the financial scandals.

Our goal here is therefore to show that controlling an organization cannot be limited to the formal aspects of internal control procedures (hard controls) and that formal and informal aspects (hard & soft controls) are both tricky to define and complementary in order to cover the risks in the most suitable way by placing the following questions:

- Are those effecting the implementation of internal control systems i.e. practitioners, board of directors, management, and staff working in the Jordanian financial system aware of soft control and act accordingly?
- Do the above mentioned parties recognize the importance of soft controls and take all needed measures to maintain soft controls at high levels?
- Are soft controls identified properly under a unified terminology and implemented appropriately in the Jordan financial sector?
- Are there any limitations and hindrances that might prevent the effective implementation of soft controls at organizational level?

In order to answer those questions, several search tools will be used with different comprehensiveness span, ranging from using current literature to questionnaires. However, the analysis section will cover the details of data collection, validation, analysis tools, and results followed with the appropriate recommendations.

1.2. Objectives of the Study

Soft controls by reason of existence are being considered the backbone of internal control systems; they are a prerequisite to ensure the implementation success. As a consequence, the goals of this thesis therefore are:

- To investigate the level of awareness in soft controls among internal control practitioners, board of directors, management, and staff working in the Jordanian financial system.
- To examine the perception of the importance of soft controls in the financial sector as an important ingredient in the internal control system.
- To examine the extent to which soft controls are implemented by the financial institutions in Jordan.
- To investigate the limitations and problems facing the effective implementation of soft controls
- Other technical objectives are there and concern:
  - Finding out whether there is a causal relationship between variables. However, causal relationships could also be tested in the presence of controlling variables through using the partial correlation technique.

The questionnaire includes different scales that could be used as independent or dependent variables to check these relationships through conducting correlation analysis.

- Finding out the effect of differences between group of respondents regarding a particular perception e.g. is there a significant difference in the mean soft control awareness scores for people who hold professional certificates and who do not? For this sake the independent-sample T-Test will be used.
- Standing on the predicting power of certain questionnaire variables on particular outcomes, through using the multiple regression.

1.3. Importance of the Study

To the best of the author knowledge, this is the first study of its kind in the Arab region, however similar studies at international level are rare and narrow in terms of coverage span, and started coming in recently by researchers' sense of the importance of this type of control. On the other side, it is true that the internal control systems within the overall content have talked about this kind of controls, but without explicit reference to being soft controls, the soft controls have been discussed usually under what is called the control environment or the internal environment. In the meanwhile others tried to shed the light on the soft controls by discussing the tone at top issue.

This study will bring to the reader an empirical documentation about the importance of soft control for financial institutions; however results could be generalized to other domains.

Different parties will benefit from this study, for instance the central bank of Jordan might take the opportunity of using the results of analysis as a guiding basis for the banking community, the internal control institutes could make use of the theoretical and practical parts of the thesis in order to boost up the internal control materials needed to obtain the professional certificates, control practitioners are interested in this study for the sake of the proper set up of internal control systems at their workplace.

1.4. Hypotheses of the Study

H1. There is a strong awareness level in soft controls among parties interested in internal controls prescribed earlier.

H2. There is a sound and clear perception to the importance of soft controls in the financial sector in Jordan as essential ingredient in the internal control system.

H3. There is an effective implementation of soft controls in the Jordan financial institutions.

H4. There are no seen limitations and/or problems facing the effective implementation of soft controls.

1.5. Organization of the Study

This thesis consists of 6 chapters emphasizing the need for soft controls as a driver for the effective implementation of the internal control systems. Chapter one briefly discusses the concept behind soft controls and the challenges affecting the implementation of soft controls, in addition to the objectives and the hypotheses of the study. Chapter two gives explanations about internal control systems in general their objectives, components, and limitations. In addition, the chapter discusses also the evolution of hard controls and holds a comparison between soft and hard controls, and discusses also the relationship between control environment and corporate governance on one side and the soft controls on the other side. Ethics and compliance process and what risk management frameworks tell about ethical risks in another discussion-domain in this chapter, in the end of the chapter a light has been shed on what religions told about ethics in business transactions. Chapter 3 talks about the literature review with the objective to demonstrate that the problem investigated is perceived by the internal control practitioners' community as relevant and significant. Chapter 4 presents the methodology employed by the study to achieve its objectives; it discusses the sample and population, the data collection tool and how it was validated, and the variables of the research. Chapter 6 presents the results of conducted analysis on the sample-subjects and to provide the appropriate conclusions and recommendations. Chapter 7 presents the main findings of the study and then presenting the recommendations necessary in order to put into effect any needed measure to make the soft control playing the supposed role in the effective implementation of internal control systems.

Chapter Two

Theoretical Background

Table of Contents

This chapter is intended to provide a theoretical background on the internal control. Section 2.1 provides a brief on its objectives, components, limitations; Section 2.2 introduces the concept of soft controls, the role of ethics in internal control, and holds a comparison between hard controls and soft controls, and if there is a balance between both of them in terms of their ingredients, and finally discusses an example case of soft controls. Section 2.3 discusses the interrelationships between soft controls and the control environment. Section 2.4 tells about whether soft controls are complementary or substitution to hard controls. Section 2.5 explains the relationship between soft controls and entity specifics and the classifications of organizations in relation with their degree of need for soft controls. Section 2.6 discusses the ethics and compliance process using the Plan-Do-Check-Act cycle and what risk management frameworks tell about ethical risks. Section 2.7 discusses the corporate governance and its similarities with soft controls. In the end section 2.8 gives an insight about ethics in religion-driven civilizations.

2.1. What Internal Control Is?

The COSO definition of internal control as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance" reflects that internal control system is affected by people – it is not only about manuals and procedures, systems, but about the actions people take at every organizational level.

People establish tactical objectives and put actions in place to achieve those specified objectives, furthermore, issues arise every day in managing entities. People may not fully understand the nature of such issues or alternatives available to them, communicate effectively, or perform consistently and cohesively. In addition, each individual brings to the workplace its unique background and ability, and each has different needs, pressures and priorities. These individual differences could be inherently beneficial or detrimental to innovation and productivity.

2.1.1. Objectives of Internal Control

As per COSO, Internal control system is intended to provide reasonable assurance and not an absolute assurance to the entity's senior management

and board of directors regarding the achievement of the entity objectives, within the following three control-wise categories:

1. Operational objectives – relate to the adequacy (effectiveness and efficiency) of operations, including operational and financial performance goals, and safeguarding of entity assets.
2. Reporting objectives – relate to internal and external reporting and whether it is financial or non-financial reporting, it is all about reliability (accuracy & relevancy), timeliness, transparency, usefulness or any other terms as set forth by recognized by control standard and best practices.
3. Compliance objectives – relate to the adherence to internal and external laws and regulations to which the entity is subject.

2.1.2. Integrated Components of Internal Control

According to internal control framework of COSO, any system of internal control should be composed of five components, the control environment, risk assessment, control procedures, information communications, and monitoring.

1. **Control environment** – it is the set of standards, processes, and organized structures that provide the basis for fulfilling and carrying out internal control responsibilities across the entity. The major principles related to the control environment are as follows:
   - 1.1. The demonstration of commitment to integrity and corporate ethical values.
   - 1.2. The independence of the board of directors from management and the role in which it exercises oversight on the development and performance of internal control.
   - 1.3. The reporting lines established along with the board oversight structures, in addition to the appropriate assignment and delegation of responsibilities and authorities in pursuing the entity objectives.
   - 1.4. The adoption of processes that demonstrates the entity commitment to attract, develop and retain competent people in alignment with its pre-specified objectives.
   - 1.5. The implementation of accountability and responsibility principle where employees are held accountable for their internal control responsibilities in pursuing objectives.

2. **Risk assessment** – involves a dynamic process for analyzing risks (from the identification to the management) in order to achieve the entity's objectives. Management considers possible changes in its internal and external environment that may limit its ability to achieve its objectives.

The major principles related to the risk assessment component are as follows:

2.1. The entity specifies SMART objectives – specific, measurable, accountable for, reliable, and time framed to enable the identification and assessment of risks relating to objectives.
2.2. The entity identifies risks that preclude the achievement of objectives and analyzes risks as a basis for determining how risks should be responded to and managed.
2.3. The consideration of potential frauds in assessing risks.

3. **Control activities** – are all actions established by policies and procedures designed to help ensuring that management directives are carried out in order to better managing those identified risks. Control activities are performed at all entity levels and at the various stages of the business processes including the technology environment. The major principles related to the control activities component are as follows:
   3.1. The selection and development of control procedures that contribute to the mitigation of risks to the acceptable levels.
   3.2. The selection and development of general control activities over information technology to take care of the achievement of objectives.
   3.3. The deployment of control policies and procedures that establish what is expected to put policies into effect.

4. **Information and communication** – information is vital to carry out internal control responsibilities among the entity, achieving the final goal of targeting the business objectives. Communication whether occurs internally and externally, provides the organization with the information needed to carry out day-to-day control responsibilities. Communication enables employees to understand internal control responsibilities and their importance to the achievement of objectives. The major principles related to the information and communication component are as follows:
   4.1. Obtaining and use relevant, quality information to support the functioning of internal control processes.
   4.2. The communication of information, necessary to support the functioning of internal control.
   4.3. The regular communication with external parties like service providers, regulators etc. regarding matters affecting the functioning of internal control processes.

5. **Monitoring activities** – ongoing and separate evaluations or mix of the two are used to assure that the five components of internal control is up and running. As a consequence to monitoring, findings are evaluated and deficiencies are communicated timely, serious matters should be reported

to senior management and the board. The major principles related to the monitoring activities component are as follows:

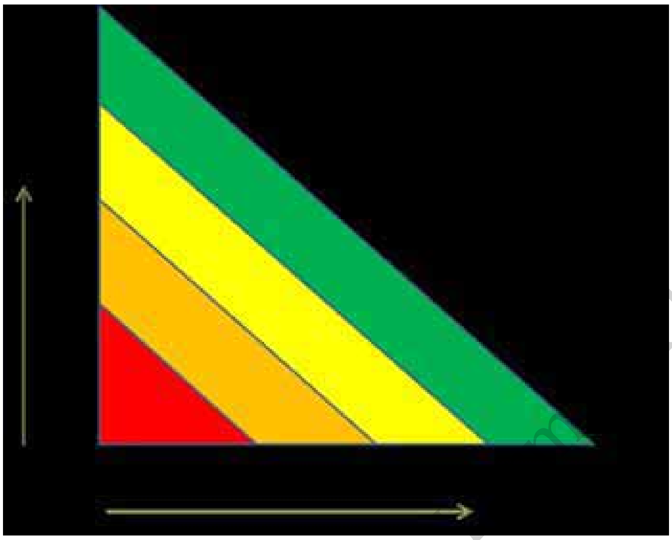
5.1. The selection, development and performing of ongoing and/or separate evaluations to ensure whether the components of internal control are present and working as intended.
5.2. The evaluation and communication of internal control deficiencies to the responsible parties, including BoD and senior management in a timely manner, in order to take the appropriate corrective action.

2.1.3. Limitations of Internal Control

While internal control can provide reasonable assurance and not an absolute assurance regarding the achievement of an entity's objectives, this means that some inherent limitations exist and negatively affecting internal control systems and they might cause breakdowns and failures. These limitations may manifest as follows:

- The bias in the human judgment in the decision making process.
- Breakdowns can occur because of human failures such as errors or omissions.
- The ability of management to circumvent or override internal controls.
- The ability of different parties to commit a collusion resulting mostly in fraud perpetrations e.g. management.
- External events beyond the entity's control.

It can be illustrated how much one can get close from the achievement of the absoluteness by approaching the human side of the limitations, see figure 1 below.



Level of Achieving Absoluteness in Relation with the Adherence Degree
Source: Prepared by the Researcher.
Figure 1

2.2. Soft Controls versus Hard Controls

The major challenge that internal control scholars, practitioners, regulators, and management, and other concerned parties are facing is “making the internal control systems work” (Jensen, 1993), and this definitely was the driver of all control efforts exerted over the past years and the heart of the evolution of management science.

As we have seen internal control is the process effected by people at all levels which designed to help the entity in achieving its objectives. From this definition it could be realized that the fact we have to live with is that the human side plays the major role in making this happen, actually internal controls provide the sustainability-base factor to the success of entities despite its field of work. So, the need to reemphasize that the importance of having organizations under control and being accountable to investors is not only a matter that falls under management discretion. But it is an identified request of internal control frameworks as well as a legal expectation through requesting management to testify about the effectiveness of internal control systems as part of the annual report of a listed entity.

2.2.1. Evolution of Hard (Formal) Controls

The evolution of formal controls (hard controls HC) happened in parallel with the development of business and the extreme desire to improve the management of institutions.
The definition of HC is sometimes difficult to determine, given that formal controls contains two dimensions, the internal controls and the formal definition of controls. Internal controls include written policies, procedures and guiding rules of individuals' behavior, they ensure the fulfillment of the entity goals, detection and punishment of wrongdoings. These established control mechanisms must be clear known to all. Therefore, in terms of hard controls we find that formal controls HC originate from the need to achieve the business objectives through achieving the control objectives related to the effectiveness and efficiency of operations, reliability of information, and the compliance with laws and regulations, examples of hard controls are: segregation of duties, general and specific authorizations of transactions, physical and logical access controls, and reporting procedures.

In addition, the volume of investment in internal control should coincide with the severity of risks facing the achievement of objectives. Among those risks are the increased complexity in operations and regulatory requirements imposed internally or externally. Furthermore, it is important to know that the evolution of these best practices, laws and regulations walked in parallel with the increase in failures and financial scandals.

It is true that hard and soft controls are the two faces of internal control. Only the formal aspect has really been developed and taken into account in the evaluation of internal control by professionals. The fact that these formal (hard) internal controls are essential does not mean that they are effective enough or the only one effective, since there is a feeling that the formal control firewall is powerless against the control breaches that everyone has been able to witness, and it is clear that nothing at least for now, has enabled entities to completely control and contain financial scandals.

2.2.2. Concept of Soft Controls (Informal Controls) SC

Previous studies have set forth different definitions to soft controls; some of these definitions can be noticed in the following context:

- Informal control enables the control of the attitudes of the actors of the entity through values, beliefs and unwritten traditions (Falkenberg and Herremans, 1995).
- Informal control coordinate employee behavior through interpersonal, social and/or cultural influence methods and emphasize work group

norms based on shared values and beliefs among peers and learned through socialization (Snavely and Snabely, 1990).

- Informal control system is composed of shared beliefs, values, moral standards and traditions that influence the behavior of employees (Ouchi 1980).
- Informal control is brought up by COSO 2013, groups together, among others, integrity and philosophy of management, ethical values and corporate culture, as well as the commitment to competence which includes the employee's skills and the policy of recruitment and training. COSO explicitly classified the environment of control as the foundation for all the other internal control system components, which brings discipline and structure.
- In its inherent section (the international standard on auditing 400 – risk assessment and internal control) the auditor has been requested to shed light at the following soft controls matters:
  - o The integrity of management
  - o Management experience and knowledge

- Examples of soft controls are as follows:

Tone at the top	Ethical climate	Trust
Morale	Operational philosophy	Corporate attitude
Commitment to Competence	Empowerment	Openness
Shared values and believes	Leadership	Expectations
Employee motivation	Integrity	

- *From the above, the researcher's perspective of soft controls as: the set of ethical values and shared beliefs that an entity adopt, and have the ability to stimulate and guide the behavior of its people and provide functioning sustainability to hard controls toward achieving the goals of the entity.*

Andersen (1987) discussed soft controls in different format "Self-control", this format is born of the assumption that individuals do not dissociate their work and material life from their beliefs and moral values. The values of an individual's circle and working environment influence his own values. Depending on the individual's personal involvement within the entity and ethical and social issues, the values of the entity and those of its managers can influence the values and principles of the said individuals (Norris and O'Dwyer, 2004). Corporate culture does become an informal control tool exerted on its employees. The way culture influences control is determined as follows: Individuals integrate a strong set of beliefs, thus avoiding direct

orders and enables the said individuals to perform their job and what is necessary for the entity.

As per the researcher, two factors are driving the behavior: the visible and the invisible factors, those invisible factors are those called "the soft controls". The stimulus of those soft controls might be hard or soft e.g. "tone at the top" has both two driving factors, the visible one is the structure of the board of directors and their independency, on the other side the invisible driver is the honesty and commitment of the board members.

Many organizational settings are being considered hand-cuffing and affect the entities ability to achieve their objectives, examples of such settings are:

- Having a dysfunctional atmosphere?
- Inculcating the "do as I say, not as I do?" idea
- Following a tone at the top that talks the talk, and does not let the talks walk
- Demonstrating an entity wide mindset "cover yourself"

It will be interesting knowing that internal controls related to these types of settings are labeled "soft." Actually, there is nothing soft about either working under or trying to improve such circumstances. This is a very hard stuff.

Unlike hard controls which are cut-and-dried, prepared in advance ones, soft controls are extremely subjective and intangible. And assessing them is not a black and white issue; neither perspective nor predictable. In other words, one size does not fit all. Furthermore, in assessing soft controls, it is essential that the board of directors and senior management provide assurance that the entity will not being brought to its knees by lagging ethics and a weak corporate culture.

2.2.3. The Role of Ethics in Informal Controls

It is seemed that the role of ethics is more ambiguous, when it comes to discuss the direct link between ethics and keenness to 'do well' or dedication to the organization. This is in fact essentially linked to the recruitment and remuneration policy adopted by the entity.

A healthy working environment cannot develop unless the following condition is fulfilled:

- No employee should create a situation where other employees feel dishonored.

- The orientation of the behavior given by the code of conduct should be perceived as “adherence to goals, sharing common values, and the development of ethical behavior”.
- Management involvement is necessary to be exercised to influence the ethics program of the entity.

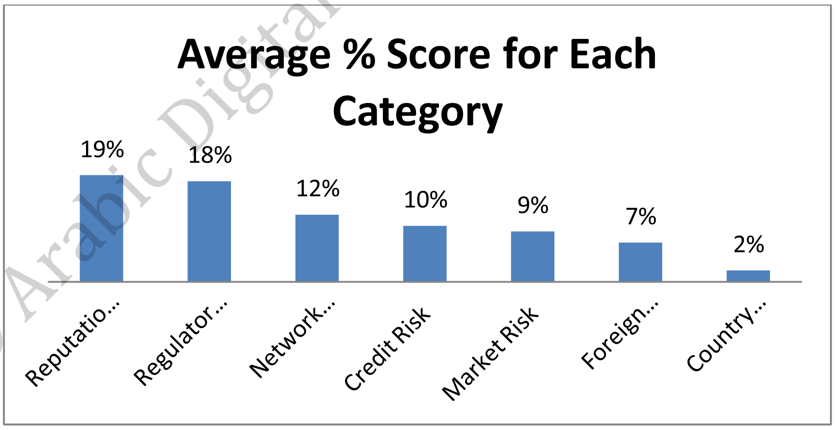
It should be noted here that imposing ethical programs might be perceived by employees to carry destructive consequences as it weakens the capacity and motivation of employees to use their own professional and moral judgment, especially in the case of new situations and may lead in the extreme to a sort of waste of skills and politicization of ethics. This is why a program of ethics should be part of the entity culture and its implementation should be subsequent to the fact that everybody is persuaded that the ethics programs is the best way to handle the error management climate.

2.2.4. Does Informal Control Possess Capacities That Considered Lacking in Formal Control?

It seems that the power of the informal system mainly lies in the control of behavior in ambiguous and unexpected situations (Falkenberg and Herremans, 1995). Controlling behavior through written rules can prove efficient against specific or expected events. But it must be noted that an entity cannot implement rules that would cover all possible situations. It follows that establishing an informal system of internal control is very important in order to manage the behavior of the employees in unexpected circumstances. Therefore, the individual acquires a set of unstated laws and norms thanks to signals sent by the workplace superiors and/or colleagues. The pressure of this control on the individual is exercised through transparent procedures such as the look of the others persons, their criticism, the feeling of guilt or shame for failure (Falkenberg and Herremans, 1995). These unstated principles spread a kind of common philosophy that guides individuals’ conduct in their actions within the entity.

The informal control system should thus help to create implicitly a control environment that could take the employee in hand, grasp his attention and direct his choices. This should also help in creating a climate of confidence and trust that formal control systems would find difficult to establish. Indeed, one of the limitations of formals control is that it cannot cover all the entity complexities. On the one hand, informal interactions between certain members of an entity, creating a feeling of confidence, are difficult to control by formal means. Furthermore, a too formal system would leave little room for initiative and new interactions, without which new advances, development and adaptation of initiatives would become difficult.

Moreover, lots of academic research has identified certain link between the values spread by the top management (tone at the top) and the quality of financial reporting (D'Aquila 1998; Reding et al., 2007), the operating performance (Booth and Schulz, 2004) or the financial performance (Verschoor, 1998; Hosmer, 1994).
New studies and empirical evidence from entities reveal that stock prices are higher, costs are lower and employees more satisfied at entities with reputations for ethical business practices and good governance (Ethics Resource Center). Not surprisingly, CEOs worldwide believe regulatory and reputation risks are the two most significant threats to business[1], figure 2 illustrates this concept.
In adapting to this new regulatory and legal environment, businesses have begun to move from philosophy to science in their approach to managing their ethics and compliance risk. What is remarkable about this move is that it is not simply a protectionist attitude but rather a refocused effort to achieve greater business advantage through improved operations and management. Entities are increasingly recognizing that managing ethics and compliance risk holistically (Emphasizing the importance of the whole and the interdependence of the risks components) is key to fostering and sustaining a strong ethical corporate culture, and that by acting ethically, they have a greater opportunity to outperform their peers and win in the marketplace.



The Severity of Reputation and Compliance Risks
Source: Economist Intelligence Unit, based on a survey of 137 risk managers
Figure 2

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[1] Economist Intelligence Unit, "Global Business Risk Rose Sharply in First Quarter of 2005, According to New Corporate Risk Barometer," press release, 14 April 2005. http://store.eiu.com/index.asp?layout=pr_story&press_id=140001814 (February 16, 2006)

2.2.5. Soft Controls, Case Study

After we have discussed the concept of soft controls and held comparisons between those hard and soft controls. An example on the implementation of soft control concepts is necessary here in order to reach insight on the nature of soft controls and its impact on the effectiveness of the application of internal control.

Our example is named as "the organizational error climate" which is considered part of the internal and control environment of the entity (corporate culture that comprises shared beliefs, norms, and common practices regarding the handling of errors). Two types of error management climate are there:

1. The high error management climate, where errors are recognized as likely to occur whenever people carry out their work tasks, and the needed ways to actively and openly handle such errors.
2. The low error management climate, where management is aversion to errors and does not support an active and open handling. Rather, such a climate may leads people to believe that they will bear some sanctions-wise consequences in case of errors.

Researches in organizational psychology suggest that a high error management climate results in better work results and more effective learning than a low error management climate (e.g., Keith and Frese 2008).

The error climate is substantially shaped by the entity's ''tone at the top'' particularly the ''tone'' that the board of management sets by its perception and decisions regarding the acceptability and handling of errors. Following the literature on ''soft'' management controls based on organizational culture (e.g., Covaleski et al. 1998; Douglas et al. 2001), an appropriately shaped error climate may serve as a control of this type.

Soft or informal controls related to organizational culture are considered important in the operational because the performance of work and work quality are largely not subject to direct observation or other formal management control mechanisms.

It is suggested that a high error management climate may encourage people to deal with upcoming errors in an active and candid way. This approach would be beneficial for the quality in both the short run (to ensure the timelines of error corrections) and long run (to learn from errors or to prevent the occurrence of similar errors and to improve the future errors handling process).

This error management climate is based on the error management theory from the psychological and organizational behavior literature (Rybowiak et al. 1999; van Dyck et al, 2005; van Dyck 2009). According to this theory, higher

degrees of error management climate lead to better performance and quality. Higher degree of error management climate involves accepting the occurrence of errors as a natural part of human activity and viewing errors as a vehicle for future improvement through the identification of problems and learning. It also involves an active and candid dealing with errors, including transparent communication about errors, sharing the knowledge of error handling with others, helping colleagues in error situations, facilitating quick error detection.

These behaviors minimize negative consequences of errors by addressing errors immediately in an active and open fashion. In this way weaknesses and systematic problems are highlighted, and effective learning is enabled, and similar errors can more likely be avoided in the future.

Van Dyck et al.'s (2005) model suggests that such behaviors and outcomes can be fostered by an organizational climate that is high in error management. This climate would recognize errors as soon they occur and wherever and whenever people carry out tasks and support ways to actively and openly deal with errors. In this climate, the entity's members would feel that it is not only normal but essential to openly and candidly discuss errors with others, to use others' help in case of errors, to thoroughly analyze errors and their causes, and to be concerned with the correction of errors.

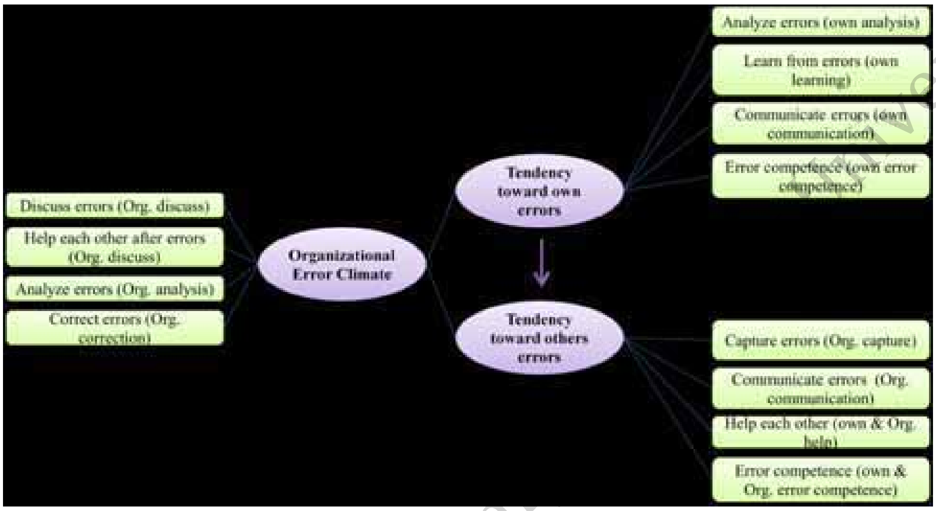
In contrast, a low error management climate involves an aversion to errors and, instead, may lead employees to expect the must sanctions in case of errors. In this climate, the mentioned practices to actively and openly deal with errors would be perceived a bad thing to do, instead of being treated in the high climate as an essential to be done.

A person's tendency toward handling errors refers to how that person deals with errors once they are detected (Rybowiak et al. 1999). Similar to the organizational error climate, the tendency toward handling one's own errors can be characterized as either high or low in error management. Management and employees with a tendency that is high in error management would exhibit a tendency to communicate about committed errors with others, thoroughly analyze errors and their possible causes, learn from them, and build ''error competence,'' whereas employees with a tendency that is low in error management would not exhibit this tendency.

The focus on employees' tendencies toward handling errors is essential for several reasons:

1. Tendencies and attitudes are likely to affect actual behavior in many situations, therefore they are considered relevant prerequisite of behavioral choices. Therefore, the unintended way in which employees look at errors will likely affect how they will actually deal with them.
2. Tendencies are capable of being shaped, this implies that it is possible to foster functional error handling behaviors by adequately influencing

employees/managers' related Tendencies. Figure 3 shows the equation of Tendencies and attitudes.



The Equation of Tendencies and Attitudes
Source: Prepared by the Researcher.
Figure 3

2.3. Soft Controls and the Control Environment

Studies highlight the predominant role of both control environment and informal controls, perceived as one of the most important components of internal control (Langfield-Smith, 1995; Stringer and Carey, 2002). Control environment is considered the foundation of an effective system of internal control, while informal controls stand out as a delicate and effective means of controlling the behavior of the players within their organization field.

The international standards for the professional practice of internal auditing (standards) glossary define the control environment as: "The attitude and actions of the board and management regarding the significance of control within the organization", the control environment provides discipline and structure for the achievement of the primary objectives of the internal control system.

It could be said furthermore, that the control environment embraces quantitatively and qualitatively the encapsulate soft controls, not only because the control environment is the basis of all following internal control components including those tangible control procedures that come to life after we have already have in place those soft controls which are considered integral part of the control environment.

Control environment is defined according to COSO as "the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization" and while the control environment is defined as a set of standards, the board of directors and senior management in all means establish the tone at the top regarding the importance of internal control including expected standards of conduct. Management reinforces expectations at the various levels of the entity. As per COSO the control environment comprises:

- The integrity and ethical values
- The parameters of performing the oversight role of the board of directors
- The organizational structure and assignment responsibilities and delegation of authorities
- The process for attracting, hiring, developing, and retaining competent people

After all, the resulting control environment has a huge impact on the overall system of internal control. The control environment is influenced by a variety of internal and external factors, including the entity's history, values, market, and the competitive and regulatory landscape. It is defined by the standards, processes, and structures that guide people at all levels in carrying out their responsibilities for internal control and making decisions. It creates the discipline that supports the assessment of risks to the achievement of the entity's objectives, performance of control activities, use of information and communication systems, and conduct of monitoring activities.

The core principle of control environment relates to the demonstration of commitment to integrity and ethical values. The following points highlight the important characteristics relating to this principle:

1. Sets the tone at the top – The board of directors and management at all levels demonstrate through their actions, and behavior, and directives how much is important the integrity and ethical values in supporting the good functioning of the system of internal control.

   Management and the board of directors are expected to lead by example (let your talks walk) in developing the values, philosophy, and operating style for the entity. They take into account the expectations of the various entity stakeholders (employees, customers, investors, etc.) in addition to the surrounding social and industry norms. The resulting expectations are expressed to varying degrees of formality in the form of:

- Values and mission statement
- Codes of conduct
- Policies and procedures
- Operating principles
- Guidelines, directives, and other supporting communications
- Actions and decisions of the board of directors and management levels.
- Perception and attitudes toward the deviations from expected standards of conduct

These elements reflect the expectations of integrity and ethical values and the degree to which they are applied in the decision making process at all levels of the entity, by service providers, and by business partners. They articulate and reinforce the commitment to doing what is considered right, and not just what complies with laws and regulations, so that these priorities are understood and embraced.

The degree to which these expectations are applied by the board of directors and senior management and not only communicated by them characterizes the tone at the top throughout the entity.

Tone at the top is impacted by the following factors that send a clear message to the entity and affect positively or negatively the conduct of people in the entity:

- Operating style
- Personal conduct of board of directors and management
- Their attitudes toward risk, which may be conservative or aggressive
- Degree of formality in implementing internal controls
- Personal bad judgment
- Lack of receptiveness to bad news
- Unfairly balanced compensation practices

A history of ethical and responsible behavior by management and the BOD and demonstrated commitment to addressing misconduct send strong messages in support of integrity. Employees are likely to develop the same attitudes about right and wrong as those shown by management. Individual behavior is often influenced by the knowledge that the CEO has behaved ethically when faced with a tough business or personal-

based decision, and that all managers have taken timely action to address misconduct.

A consistent tone from the board and senior management through to operating unit management levels helps establish a common understanding of the values, business drivers, and expected behavior of employees and partners of the entity. This includes the various divisions sometimes referred to as "tone in the middle" and "tone in the bottom" in the larger entity structures. Such consistency helps compiling the different exerted efforts across the firm in pursuing the entity's objectives.

Tone at the top and throughout the organization is fundamental to the functioning of an internal control system. Without a strong tone at the top to support a strong culture of internal control:

- Awareness of risk can be undermined
- Responses to risks might be inappropriate
- Control activities may be wrongly defined or not practiced
- Information and communication may ineffective or inefficient
- Feedback from monitoring activities may not be acted upon.

Therefore tone at the top can be either a driver or a barrier to internal control.

2. Establishes standards of conduct – setting out the expectations of the BOD and senior management concerning integrity and ethical values and the entity's behavior, activities, and decisions in the pursuit of objectives by:
   - Establishing what is right and wrong.
   - Providing guidance for moving forward considering the associated risks.
   - Reflecting the expectations of the entity's stakeholders in the governing rules, standards, including the corporate social responsibility.

   Ethical expectations, norms, and customs can vary across different civilizations. BOD and management or any equivalent body establishes the standards and mechanisms for the entity to understand and adhere to doing what is right, and define the process and resources for interpreting and addressing the potential for deviations. These expectations are

translated into an organizational statement of shared beliefs, values, and standards of conduct.

The organization demonstrates its commitment to integrity and ethical values by applying the standards of conduct and continuously challenging the difficult situations particularly when faced with difficult decisions for instance, it might asked: Does it infringe on the organization's standards of conduct? Is it legal? Would we want our customers, regulators etc. to know about it?

Integrity and ethical values are core messages in the organization's communication channels and training programs. For instance, an entity that has high employee retention rates typically provides training on corporate ethical values and organizational culture. During such training, employees learn how the ethical climate has developed in the firm. In addition, employees are provided with examples of how integrity and ethical values have assisted in identifying issues and solving problems and the importance of speaking up and raising concerns.

The firm's standards of conduct extends outside the range of the entity, they are also communicated regularly to outsourced service providers, for instance enforcing internal control for compliance with product quality standards.

3. Evaluates adherence to the code of conduct – there are several processes in place to evaluate the performance of people across the entity and in the surrounding marketplace against the entity's expected standards of conduct and its integrity and ethical values.
   It is important that these measuring standards are communicated through the organization's policies and practices. Some firms require formal acknowledgment of receipt and compliance with such standards in order to be sure that the standards are being followed literary and in soul. The actions, decisions, and attitudes of individuals are evaluated by management or an independent party.
   The lack of adherence to standards of conduct often stems from situations such as:

   - Inefficient or unclear conveying the expectations regarding adherence to ethical values

- Unbiased oversight from the board of directors on the management's compliance to standards
- High decentralization with no adequate oversight, so no reporting escalations regarding events happening at lower levels.
- Pressure extended by managers, peers, or external parties to cut corners or engage in illegal behaviors
- Compensating performance goals that create compromises to ethical behavior e.g. compensating high achievement of targets in the short run
- Failure to address ineffective controls
- No whistle blowing process in place
- Inadequate investigative and rectification activities for alleged misconducts
- Weak internal audit function
- Inequitable and inconsistent applying penalties for improper conduct, or penalties are not publicized, so they lose their deterring power

Evaluations of employees' compliance with standards of conduct are part of a very systematic process of escalations. The process requires that management:

- Defining a set of whether leading and current key risk indicators KRIs (warning signs) to identify issues related to the standards of conduct e.g. breaches of confidentiality, Such indicators are refined periodically and/or when necessary to help providing early warning or before issues get repeated
- Establishing continuous and periodic compliance procedures to ensure that expectations are being met both internally and by stakeholders like service providers
- Identifying, analyzing, and reporting business conduct anomalies and trends to the board of directors and senior management. Mechanisms for identifying issues include hotlines.
- Considering the integrity of its leadership especially when it comes to compensation and promotion decisions
- Compiling and investigating allegations centrally and independently
- Conducting investigations and analyzing root causes
- Following up to ensure corrective actions are timely implemented

4. Timely addressing of deviations – Deviations from the entity expected code of conduct are identified and rectified timely and consistently.

   Evaluations may be conducted by a pre set managerial process or by an independent party. Individuals can also report irregularities through formal and informal communication channels, such as a whistle-blowing program, a hotlines, down-up feedback processes, and regular staff meetings.

   The abovementioned discussion, with no doubts demonstrates that the control environment is considered an incubator to the soft controls; *the issue of soft control is that soft controls should be implemented in earlier stage than hard controls*.

   Control environment or corporate culture represents an agreement for all the entity members, ethics and integrity are essential to the structure of corporate culture, ethics and integrity have come to be called "soft controls". *The importance of soft controls comes from the fact that the lack of such soft controls like management philosophy, integrity, and ethics increases the possibility that other more traditional controls such as approvals and reconciliations may be overridden*.

2.4. Soft and Hard Controls: Complementary or Substitution

Although formal and informal controls do coexist in today's internal control system, understanding the nature of interaction between these two types of internal control is a matter of debate among researchers. It is therefore difficult to make sure that the use of hard or soft controls could replace or could complement the use of the other.

Within the context of multinational entities which require more flexibility and autonomy for their subsidiaries, an initial viewpoint consists that the two faces of control would lead to a more efficient level of control. Martinez and Jarillo (1989) underline the move "*from structural formal subsidiary controls towards informal controls*", a conclusion shared by Gomez & Sanchez (2005), on the basis of their research using a sample of 74 Mexican subsidiaries of US multinational entities MNCs within the manufacturing sector, point out that this shift from hard to soft control is moderate by four criteria:

- Globalization pressure
- Pressure from local regulations, this makes these companies likely to use all kinds of control mechanisms, formal and informal.
- Local dependence

- Educational requirements, this makes the subsidiary appear to discourage formal controls while stimulating informal ones.

In the same way, based on a series of four case studies during systems development projects, Kirsch (1997) suggests that all stakeholders use different mechanisms of formal control (existing or created) and supplement some of them with mechanisms of informal control: “Throughout this process of construction, the choice of particular control mechanisms depends on task characteristics, role expectations, and project related knowledge and skills” Sitkin and George (2005), in the light of two case studies, conducted successively on a first sample of thirty Human Resources Managers and a second one of fifty-one HR executives, using different research design, found that threats to legitimacy and trust would lead to a non-significant change in reliance on formal control, with a decrease in reliance on informal control, results that are in contradiction with the two previous researches and not consistent with the mainstream institutionalist traditions (DiMaggio and Powell, 1991).
A second point of view consists rather on putting the emphasis on the complementarity between formal and informal controls. Using the grounded theory approach applied to a sample of nine entities in the trucking industry, Mello and Hunt (2009) suggest that both formal and informal control methods are used in various combinations and that no single control method is completely effective in isolation. It is in this direction that the relation between formal control and informal control can only be considered from the viewpoint of complementarities. One cannot be the substitute for the other, but it is complementary.

That is why formal control would develop on the basis of a perspective with informal control. It is necessary that the formal system be in harmony with the informal one so that the entity, its objectives and its functioning go in the same direction, resulting in a secure, sound and reliable system.

The articulation between the formal and informal system is essential for an internal control system to be efficient. Even when some entity charters oppose fraud and non-compliance with the internal rules of the group, it turns out that, if there is a "performance race" atmosphere within the departments, the formal rules in place would have no effect. On the one hand, this situation may create imbalance or instability in the individual, partly due to the problem of purely quantitative indicators and to the possible recruitment of bad people in the workplace ‘jercks’. On the other hand, this situation could lead one to consider that the explicit and formal principles of the entity are not made to be respected. In contrast, if informal control could reinforce formal control, then a climate of confidence and trust would emerge and

create a strong degree of cohesion in the heart of the entity and the performance level will be increased.

It is therefore necessary that formal and informal control be in harmony and developed in a balanced way according to the characteristics of the entity, so as to form a single set of efficient controls. Control harmonization is a prerequisite for creating a stable and efficient entity.

Putting informal controls in the front is not enough for getting the entity under control, and forgetting them is equally carrying serious dangers. Seen from this point of view, the research of Snavely and Snavely (1990) remains qualified, it is based on a sample of 122 staff nurses from three work medical units argue that both formal and informal systems contributed to efficient error detection, suggesting that a combination of the elements in both systems may maximize detection. However, findings indicate that satisfaction with control was significantly greater under formal control dimensions than under informal control ones and that only formal control system were found to be highly associated with effectiveness at improving performance deviations.
Finally, Tiwana (2010) propose a conciliatory approach which develops the idea that these competing perspectives are mutually compatible rather than contradictory because informal and formal control mechanisms can simultaneously be complements and substitutes. Using data from 120 outsourced systems development projects, it is shown that informal control mechanisms strengthen the influence of formal control mechanisms on systems development (complementary effects) but weaken the influence of formal outcome control mechanisms (substitutive effects).
In fact, the review of the literature shows divergent responses concerning the nature of the interaction between hard and soft controls.

Several authors agree in asserting that both indivisible aspects make a whole in terms of controlling organizations, and that informal control is a key component, without which the entire internal control system would „seize up‟ and open the door to mistakes and fraud.
For managers, the analysis of this interaction might help in drawing attention to the fact that there is no perfect and well-balanced situation between "soft and hard controls" (informal and formal controls). The ideal combination depends for example on:

1. The nature of risks affecting the entity – for example, as the reputational risk is central in banks, soft controls run the show
2. The root causes that risks stem from – for example, the risk of fraud originates from several unseen factors related to the pressure or human needs or ethical issues
3. The given priority to efficiency or to effectiveness.

4. The type of formal control mechanisms - “activity-based” or “result-based”
5. The criteria related to the external or internal environment – to the characteristics associated with the target of the control or to the search for legitimacy.

To sum up, is there any ideal formal or informal recipe of control so as to achieve the ultimate ingredients of the smooth functioning of the control procedure? No one can tell about the right amount, even if some situations are more conducive to a prevalence of formal controls or informal controls, as we tried to shed light on.

The IIA VP of standards and guidance says: one of the key lessons is the realization that integrity, ethics, and management operating style have just as much to do with an entity’s control environment as do the traditional internal controls. She says “the control environment is the foundation of every other control in the organization.” She adds “it is the basis or everything we hold near and dear to having a solid, fully functional organization.”

2.5. Soft Controls and Entity Specifics

Are all entities need soft controls ingredients on the basis of “better spread concept” disregarding their specifics?
To be realistic, control environment components vary in their degree of need and applicability as entities vary in the way they are classified. To understand the differences in entities, we will look at the various ways in which entities can be classified. Then, we will discuss a model in which these classifications serve as variables that direct the scale in a specified way, thereby determining how much soft controls are needed according to the entity location on the landscape.
Although all organizations have some common characteristics, no two entities are identical. Organizations have different structures, goals, constituencies, operational styles, tasks and surrounding environments.

2.5.1. Classification of Organizations

In the following passages we will take a closer look at organizations from different point of views, such as organizational structure and leadership style and how these characteristics can influence management control.

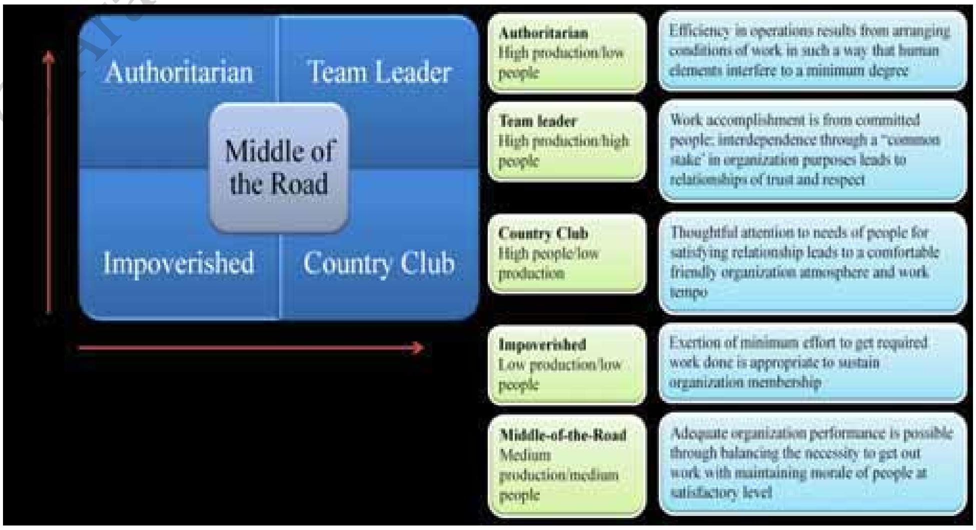
Mintzberg – Henry Mintzberg, 1979 classified organizations into a set of five clearly distinguishable variants. The type of organization influences

management of control by its coordination of people, power and dynamics. Table 2-1 illustrates this classification.

Table 2-1: Five Organizational Structures by Mintzberg

Organizational type	Characteristics
Entrepreneurial Structure	Young, small firm in a fast changing environment dominated by a single entrepreneur and managed by a single CEO, where employees are under direct supervision.
Machine bureaucracy	Large bureaucracy organized into functional divisions, decision making is centralized, produces standard products and exists in a slow changing environment.
Professional bureaucracy	Knowledge-based organization such as accounting firm; operates in a slowly changing environment.
Divisionalized bureaucracy	Combination of many arm bureaucracies, each producing different product or service, all under one central management.
Adhocracy	Task force organization, such as an ad firm, designed to respond to a rapidly changing environment and characterized by groups of specialists organized into short lived multidisciplinary task forces.

Blake & Mouton – they published a well known model on the different management styles in organizations (Blake & Mouton, 1964). The model, which debuted in the beginning of the *Contingency Viewpoint* of management, noted that different management styles can be useful for certain situations. Blake & Mouton's model has five leadership styles that can be plotted in a grid along two variables, being the concern for people, and the concern for production. Figure 4 shows the Blake & Mouton Managerial Grid.



Blake and Mouton Managerial Grid
Figure 4

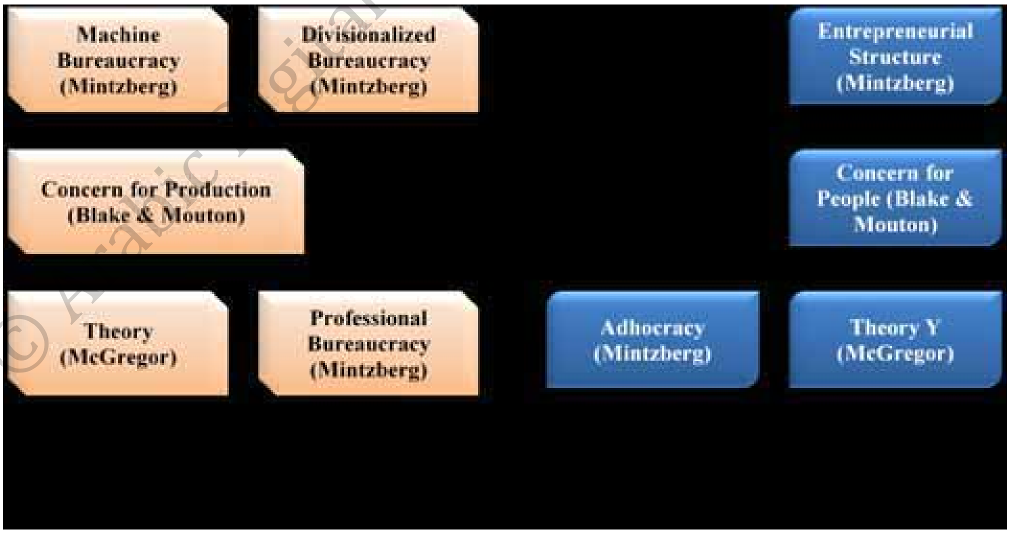
Mcgregor – in 1960 Mcgregor emphasized two distinct leadership styles which are based on the beliefs of managers about their subordinates. The first of these leadership styles is labeled Theory X; it holds that leaders tell subordinates exactly what's expected of them, as employees require direction as much as possible. Furthermore, Theory X states that employees dislike work, and will avoid it if possible. Managers should force employees to get them to work. In contrast, the leadership style dubbed 'Theory Y' assumes that people like to work, and that employees who are committed to the entity's objectives will exercise self-direction and self-control. Additionally, employees accept and even seek responsibility in the workplace, which allows leaders to consult with their subordinates; allowing them to take part in the planning and decision making process. With Theory Y, leaders believe people will work hard, cooperate and have positive attitudes towards the organization.

Theory X and Y impact the effectiveness of management of control in an organization depending on its goals, either Theory X or Y will be best suited to achieve these goals. On the other hand, when taken this theory too literally, X and Y seem to represent unrealistic extremes. Theory X emphasizes strict procedures to achieve business goals in a controlled manner. In contrast, Theory Y stimulates to manage people by empowerment. Most organizations require a leadership style that falls somewhere in between these extremes. Table 2-2 summarizes McGregor's Theory X-Y.

Table 2-2: Mcgregor's Theory X-Y

Theory X	Theory Y
The average human being has an inherent dislike of work and will avoid it if he can	The expenditure of physical and mental effort in work is as natural as eat or rest.
Because of the employees dislike for work, most people must be controlled and threatened before they will work hard enough	Control and punishment are not the only ways to make people work, man will direct himself if he is committed.
The average human prefers to be directed, dislikes responsibility, unambiguous, and desires security above everything else	If a job is satisfying, then the result will be commitment to the organization.
	The average man learns, under proper conditions, not only to accept but to seek responsibility.
	Imagination, creatively, and ingenuity can be used to solve work problems by a large number of employees.

Fidler – Fiedler Contingency Model is a synthetic model for leadership styles which proposed in 1967. It was argued that successful leadership depends on matching a leader's style to a situation's demands. According to Fiedler, a manager has to understand his or her leadership style, diagnose the particular situation, and then match style and situation. Fiedler also distinguishes between task-oriented leaders who only want to get the job done and relationship-oriented leaders who place greater value on people than tasks. Most leadership and organizational models discuss two ends of a spectrum. Leaders believe in Theory X or Y, they are either more task-oriented or people-oriented, and organizations are loosely organized in the form of an Adhocracy, or much more strictly organized in the form of Machine Bureaucracies. We can relate to these extremes, as we are able to name numerous examples of entities that appear to fit well with either end of the spectrum – whether it is the Theory X Machine Bureaucracy in the form of a car manufacturer, or if it's the Theory Y Adhocracy in the form of an ad-agency. Similarly, most of us will be able to pinpoint where the organization that we are part of is located.
Simply put, some organizational aspects (such as leadership style or organizational structure) seem to intuitively match well with one another. Figure 5 graphically displays these aspects.



Organizational Theories in a Task-People Minded Spectrum
Source: Alex de Leeuw & Clyve Lo-A-Njoe
Figure 5

2.5.2. Other Indicators

Given the organizational spectrum discussed above, we are able to add more indicators to this spectrum affecting the management of control.

Innovation and Creativity

Some organizations stimulate their employees to be creative, flexible and innovative. Organizations that do so appear to fit well with the right-hand side of the spectrum. These types of organizations are often blooming when their employees are given the needed empowerment to be successful. Using restrictive 'tough boss' leadership style and strict management control would be counter-productive in such an environment. Similarly, the 'Theory X manager' will most likely clash with employees soon after manager's arrival.

Size and Maturity

Small and young organizations will find themselves on the right side of the spectrum as well. Employees at these organizations will most likely be empowered to do whatever it takes to grow and survive in the earliest stages of organizational maturity. Managers at start-ups will most likely encourage entrepreneurship and employee empowerment. Large diversified organizations are difficult to control and manage from the outset, simply due to their size and complexity. Therefore, smaller organizations have an edge when it comes to management control – their structure is often simple, and lines of communication are short and informal.

Philip Wickham argues that entrepreneurship can also be seen as a management style in which there is a strong focus on change and opportunity (Wickham, 1998).

Competition

Strong competition can also be a significant indicator for a specific organizational structure or leadership style. In the highly competitive Technology like telecommunications industry, even the monopolists are facing tough battles for survival. This shift in market conditions forces them to increase flexibility, foster entrepreneurship, and to struggle for innovation. In other words, these entities are required to move to the right of the spectrum to gain competitive advance against young and agile organizations. Figure 6 illustrates the need for soft controls to this type of entities that are characterized by being adhocracy, innovative, agile, and high level of empowerment to people.



The Need for Soft Controls With Respect to Certain Organizational Combined Factors
Source: Drs. C. Lo-A-Njoe and A.P. de Leeuw
Figure 6

2.6. Soft Risk Analysis

As the old adage says, an organization is only as good as its people. This is especially true in ethics and compliance driven risks e.g. legal risk, where successful management depends as much on how leadership and culture influences employee behavior as on quantifiable controls and procedures.

The ethical health of an entity's culture has gained importance due to high-profile business failures where material weakness was found in the control environment. Control environments with strong cultures of compliance are conducive to the minimization of risk (a positive control environment), while those with a culture of non-compliance do little to reduce risk (a negative control environment). Widely accepted control models emphasize the importance of soft controls. The U.S. Sentencing Commission has recognized that compliance is an outcome of ethical behavior and requires a pervasive ethical culture with supporting business processes in place. The newly amended guidelines now require entities to expand their program beyond compliance to "compliance and ethics" as a mean to prevent and detect criminal conduct and foster an organizational culture that encourages ethical conduct and a commitment to legal compliance.

2.6.1. Ethics and Compliance Process

This is why there is a need to build a sustainable ethics and compliance process through using the model illustrated in figure 7, which includes 4 stages leading to this end.



Ethics and Compliance Process
Source: Dr. Shewhart of the Bell System, 1930s
Figure 7

1. Plan

Planning incorporates the identification of ethics and compliance risks that usually requires two cycles:

- In the first cycle, the evaluator uses existing knowledge of risks to design a specific tool in order to collect information about ethical risks like a questionnaire or an interview process or any other relevant tool, through which key employees are being asked to evaluate the occurrence of known risks, such as the following:

  - Business ethics failures like breaching confidential information or discrimination.
  - Inappropriate behavior
  - Taking excessive risk due to improper incentives structure or aggressive goals in the short run.
  - Lack of commitment to competence
  - Employee turnover due to unhealthy workplace environment
  - Different kinds of frauds, that go undetected due to management overriding of internal controls

- The spread perception that employees hold their position capacities because of their close relationships with executives
- Undemonstrated risk consciousness from management side
- Workplace related risks, like unequal opportunities, harassment, and discrimination
- Intellectual right violations

- In the second cycle, the corporate ethics and compliance evaluator cross-references data gathered from different tools to build a profile of enterprise-wide ethics and compliance risk.

The seriousness of business unit risks is visible only to those who are able to see the whole landscape by holding the enterprise-wide data, and can see how risks from across an organization pool together. For example, assessing the risk of antitrust action generally requires a national picture of operations, like in the case of the GCC countries, an understanding of the markets of the member states where an entity operates.
Keep in mind that because soft controls are highly subjective, evaluating them objectively can be a challenge. So, persuasive evidence indicating soft control weakness should be obtained here. If persuasiveness cannot be found, the perception of the evaluator should be pointed out.

Because ethics and compliance management depends heavily on soft controls, an effective assessment of ethics and compliance risk must take into account the employee behavior and organizational culture. So, when lunching an interview about ethics and compliance, entities should keep in mind three basic questions:

- What has hurt in the past? Making use of historical ethics and compliance failures or weakness in the internal control system provide a huge leverage to internal experts and employees intended to promote ethics and compliance.
- What is hurting on daily basis? It is important to keep track of ethics and compliance data on "real-time" basis through hotline activities or from cases under investigation etc.
- What might hurt in the future? It is important to analyze the changes in ethical practices and the trends in business culture, as a result of the analysis of changes in laws & regulations, for instance managers who put pressure on employees to meet unrealistic goals are likely to encourage unethical behavior.

The manifestation of business effects and business objectives has negative correlation, as ethical risks increase, business objectives tends to fail, not because of specific internal or external threats, but because management's

philosophy or operating policy's is wrong for the right now circumstances, there is a low level of commitment to competence.

In assessing the ethical risks we have to recognize the basic limitation of legal boundaries: ethical risks in particular, such as conflicts of interest, occur mostly in the space between policies. So carefully defining and assessing risks allows entities to anticipate these grey areas and equip employees with the right tools to make ethical decisions when they encounter them.

In defining ethics and compliance risks we might use different tools as follows:

- Using a risk maturity model (attributes model). Aappendix 3 illustrates the different control maturity elements
- Workshops where key employees from a division contribute in the self assessment of those risks
- Entity wide questionnaires
- Using risk-based audit methodology
- Benchmarking between entities and/or different departments in the entity
- Soft control reports

Planning is further consists of evaluating the results reached after we have performed our checks and detection processes. This considered a pure good business practice, so entities could actually increase their risk by uncovering problems they were not equipped or legally required to handle. This is why Sarbanes-Oxley Section 404 requires management to take responsibility for and assess the effectiveness of internal controls and procedures.
As the evidence continues to build that ethical behavior is not only expected from regulators and prosecutors, but also provides a financially measurable competitive advantage, the ethics and compliance process is evolving into an element of entity strategy.
This graduation of ethics and compliance into a business process hinges on an effective feedback loop, which allows entities to continually refine and adjust the program as they would any other process tied directly to the bottom line.

2. Do

Do by designing a program with both hard and soft controls that prevents ethical and compliance failures begins with a directory index of existing business values, codes of conduct and compliance guidelines throughout the organization. When conflicts and gaps arise, entity management will have to consult with the relevant function e.g. human resources or legal department in order to build consistent and comprehensive guidelines for employees.

A self assessment program might be used to maintain such a prevention program up and running through continuous assessment to the ethical and compliance risks, this assessment might take several forms as mentioned in the previous step, this section will focus on the self assessment technique.
Self-assessment is being used to maintain and continuously improve the entity's culture and legal compliance and ethical business conduct. Undertaken annually encompassing all the entity's division, subsidiaries and staff function, an assurance might be obtained regarding the effective functionality of the ethical program. Such a methodology is intended to:

1. Reassessing the level of ethical risks in all functions that contribute to the risk exposure with an emphasis on the changes that might bring new ethical and compliance risks; in addition the analyzer should review the employees' performance to stand on how previous ethical programs have contributed in enhancing ethical behavior.

2. Developing of a list of major ethics and compliance topics, such as discriminations, business gifts, lobbing etc. such a list might be prepared by utilizing a list of operational accidents that negatively affected the entity in the past. Appendix 2[2] represents a not all-inclusive list of operational losses that could be used in preparing such a list.

3. Analysis of existing KRIs and KPIs, so the whole picture on ethical and compliance risk is clear and measurable, this also enables the analyzer to decide on how to proceed. Examples on KRIs are:
   - Historical cases of business conduct violations
   - Significant potential litigations

4. Development of control action plan, so all identified ethical risks become prioritized and compiled in an action plan.
   Part of the prevention stage might be the design of certain soft controls that help in the effective management of ethical and compliance risks:

   a. Instilling an ethical education program across the entity; five important keys to do so are as follows:

      1. Engaging management in driving successful ethics education – Employees are more receptive to ethics-based change when their leadership not only talks about values, but when it makes its talks walk, in other words when leadership embodies them in practice.
      2. Promote the benefits of interactive engagement from the new developments in e-learning technology – Advances in interactive

[2] International Convergence of Capital Measurement and Capital Standards, June 2004.

technology permit nowadays the online ethics education to function as a two-way form of communication, giving the programs greater modification power.

3. Combine the geographic width of ethics education with a focus on professional relevance – the regulation versus deregulation, the vulnerability of reputation may impose the necessity that educational material should address the specific ethical dilemma that a particular audience is likely to face. This will make ethics education seem more relevant to employees.
4. Move beyond the "carrot-and-stick" approach – ethics and compliance education should appeal to our noblest aspirations and should not be focused on the fear of getting caught.
5. Create certification programs that attest to effective education and compliance – An effective education program teaches employees the risks, liabilities and corporate interests at stake in the ethical dilemma they face. In turn, certification allows the entity to make well known its measure of compliance, while helping to ensure that compliance reflects a considerate, collective appreciation of the values underlying the relevant issues.

b. Tuning third parties ethical systems – many entities expect to establish a disciplined approach to improve their entire ethical ecosystem, using one or more of involving partners in risk assessment activities, train partners on the expected business practices, uses the entity forum to educate partners, helping partners in creating their own code of conducts, train partners on different ethical issues, conduct pre-relationship due diligence ethics discussions to ensure that there is the understanding of abiding by standards of conduct, assess the maturity and effectiveness of suppliers' compliance programs through surveys and research of supplier history, and Promote codes of conduct and reporting hot-lines regularly with business partners.

c. Creating constitutional code of conduct – a blueprint code of conducts fails to inspire employees with the spirit of ethical behavior, instead the constitutional one detail the fundamental principles, values and framework for action within an organization. Several factors should be considered here:

1. Code of conduct should look beyond legal boundaries to tone at the top.
2. Taking the authority from mutual agreement, not from those in authority.

3. Asking for employee buy-in, the code of conduct should be explained in terms of performance objectives.
4. Demonstrating to employees that the responsible conduct can bring alignment between employee values and the entity's.
5. The ultimate goal from a code of conduct is qualitative – opining dialogue and a culture of accountability.

3. Check

Compliance with any ethics program requires providing assurance that employees at all levels are in compliance with this program literally and spiritually. The best bath to follow in ensuring compliance is a well-publicized variety of confidential and non confidential communication lines. With this in mind, a combination of telephone help-lines, Internet communications and designated personnel, all of which maintain confidentiality but only some of which offer anonymity, has the best chance of encouraging reporting from all employees in all locations.

Finally, the reach of entity's ethics and compliance reporting should extend beyond employees to vendors, customers and even family members.

4. Act

Ineffective enforcement can easily undermine the best planning of ethical risks (definition, prevention and detection

Efficient response begins with establishing protocols for applying expertise and objectivity to ethics and compliance allegations. Entities can create general guidelines for determining which management level and function e.g. human resources will handle such an issue and put a system in place to rapidly inform personnel.

A serious issue that affects entities internally and with respect with authority is its ability to immediately collecting the needed information, documents and computer files.

In conducting a fair investigation, reviewing all data collected and following leads beyond the targets, and as the investigation expands, entities must maintain confidentiality, protect against adverse litigation and avoid retributions.

In addition, to avoid the appearance of taking unjustified action, entities should document all disciplinary actions and processes, not just those that are whistle-blower related but all other possible sources like tips and internal audit discoveries.

A standard reporting process for all disciplinary action and related disagreements, combined with a robust detection mechanism for ethics and compliance issues, protects the entity against retroactive complaints.

In addition, a consistent implementation and documentation of response mechanisms increases the credibility and accountability of the entity in its response to wrongdoing investigations.

In responding to allegations and violations, entities should maintain a solid information system and information database, as per "*LRN, ethics and compliance risk management*" five fundamentals are necessary to materialize that:

1. Data collection methodology
2. Standardized workflow
3. Centralized organization of documents
4. Statistical reports
5. Security on need-to-know access basis

A well-executed ethics and compliance program can eliminate a significant amount of improper behavior. Weak reporting mechanisms or compliance processes can produce a similar result by catching only the most serious infractions. Experience with an entity's internal processes generally provides the context necessary to navigate among the possible interpretations of evaluation results. Internal evaluations of programs, issues, and business units help peal the statistical onion to identify root causes of ethical and compliance risks.

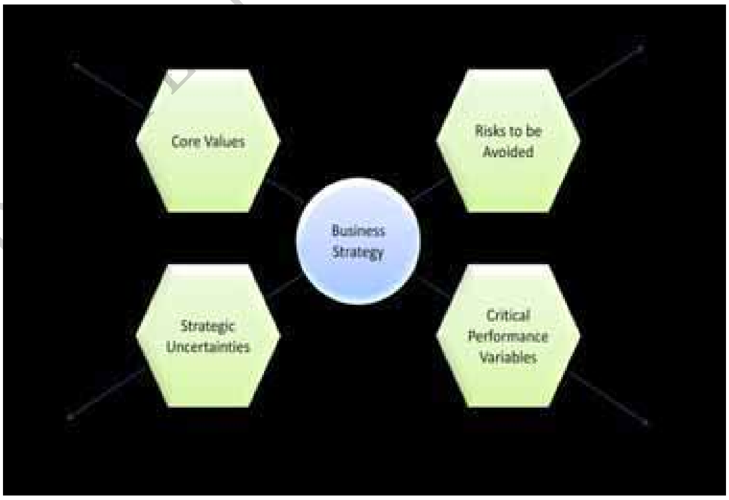
2.6.2. What Risk Management Frameworks Tell About Ethical Risks

COSO ERM – the committee of sponsoring organizations of the treadway commission ERM, 2004, page 27 has defined the control environment as "The internal environment encompasses the tone of an organization, influencing the risk consciousness of its people, and is the basis for all other components of enterprise risk management, providing discipline and structure", COSO has given also particular attention to small and midsize entities, similar entities have unique advantages in establishing a strong control environment, as employees interact more closely with top management and are directly influenced by management actions and through day-to-day practices and actions, management can effectively reinforce the entity's fundamental values and directives.

It is now obvious that COSO for Smaller Public entities relates to the indicators mentioned in our previous discussions. On the one hand the characteristics of these entities, according to COSO, correspond to organizational structures "Entrepreneurial Structure" and "Adhocracies" from Mintzberg. Similarly, a high concern for people

and the characteristics of Theory Y can be relevant contributing factors to overcome the challenges that COSO has defined for this size of entities e.g. management's ability to dominate activities, with significant opportunities for management override of control and obtaining sufficient resources to achieve adequate segregation of duties.

Simons' Levers of Control – Simons shows how managers use innovative control systems to drive continuous strategic renewal. It describes controls ('the levers') that enable business leaders to retain control of their organizations and capitalize on the autonomy and drive present at lower levels while simultaneously responding to emerging opportunities. The model takes on the challenge of finding a way to allow empowerment to flourish while encouraging accountability. It establishes a critical bridge between the disciplines of strategy and accounting and control; essentially combining top-down direction and bottom-up creativity. Simons' model is shown in figure 8.



Modeling Managers Use Innovative Control Systems for Strategic Renewal
Source: Simon's levers of control
Figure 8

The Belief System – in an empowered environment people need to understand and be committed to the mission, objectives and strategy of the organization. Belief systems explain how the organization creates value, the level of performance the organization strives for

and how individuals are expected to manage both internal and external relationships.

The Boundary System – implies that there are strict rules to comply with. However, the boundaries only define what is not allowed. Telling people what to do in procedures and rule books restricts the initiative and creativity unleashed by empowered and entrepreneurial employees. Within these boundaries everything is possible, which in turn promotes creativity and innovation, and empowers employees to do what is right.

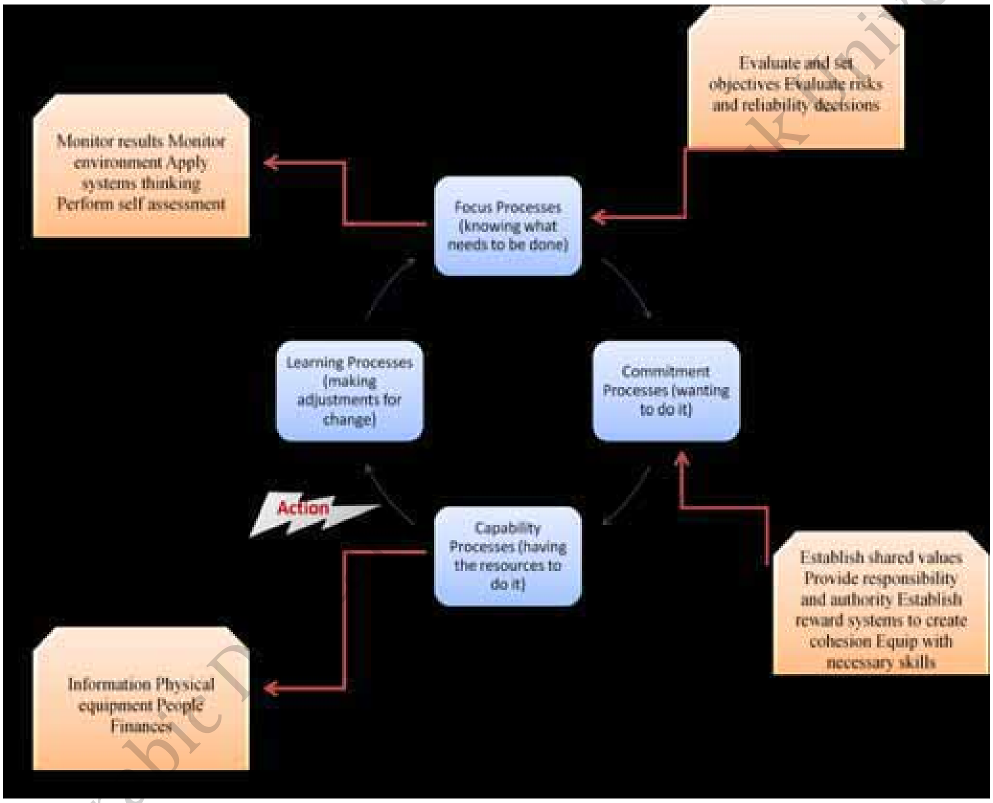
The Interactive Control System – to effectively and efficiently control an organization, management needs Interactive Control Systems. Interactive Control Systems are communication structures that managers use to involve themselves regularly and personally in the decisions of subordinates. Through them senior managers focus organizational attention and learning on key strategic issues. Interactive control systems track the uncertainties that keep senior managers awake at night (Rijsewijk, 2007).

Diagnostic Control Systems – act as a dashboard for management, instantly showing signs of abnormal behavior of the organization. Diagnostic Controls Systems can be in the form of KRIs and/or KPI's, which are tracked on a day-to-day basis. The monitoring of Diagnostic Control Systems can help an organization to keep critical performance variables within limits.

The levers of control allow, or even oblige, an organization to implement traditional internal controls, but it also encourages management to deploy other means of controlling their organization, such as monitoring or diagnostic controls.

COCO – an alternative to COSO is the criteria of control risk management model CoCo from the Canadian Institute of Chartered Accountants, which was issued in 1995. It acknowledges that the control environment is the foundation of internal control, but CoCo takes it one step further. The intent with CoCo is to address what is being felt as an imbalance with COSO (which adopts a mechanistic approach to governance and control) – the contribution is to emphasize the people and cultural aspects of control. CoCo states that effective internal control is not only enforced by segregation of duties and policies and procedures, but the model focuses on intangible things as leadership, shared values, and mutual trust, e.g. entity-level controls. It acknowledges the fact that is obvious to management: that an

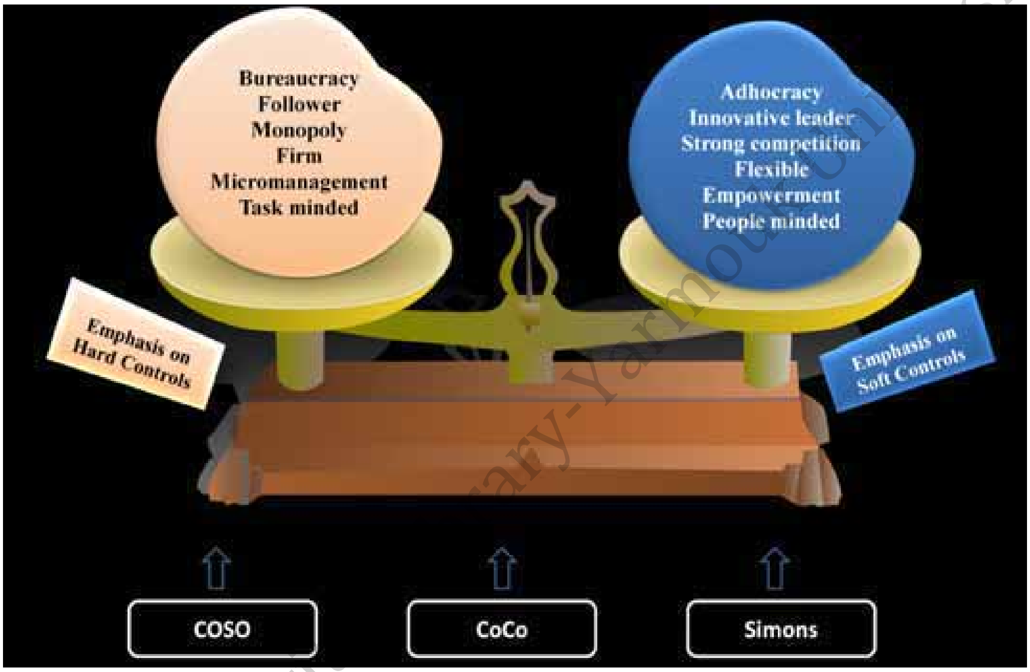
organization consists not only of processes and systems, but also of people, and that people are most often the key to success or reason for failure. CoCo therefore focuses on the commitment, capability and learning of people in the organization. Figure 9 shows the CoCo Risk Management model.



CoCo Risk Management Model
Source: Criteria of control risk management model CoCo
Figure 9

For some organizations it can be challenging to implement a full scale COSO ERM framework. For these organizations it is necessary to find other frameworks in order to be in control. We have seen that these frameworks emphasize the control environment, which is strongly influenced by the structure of the organization and the leadership style of management. *The current research point of view that Levers of Control model of Simons is a very strong framework to build upon. It is a balanced approach of empowerment and control without overlooking traditional controls*. Figure 10 below shows the combination of all of the above models, leadership styles,

and organizational structures. The figure also shows when organizations can benefit most from soft controls (shown on the right hand side of the scale).



Scaling the Benefit from Soft Controls
Source: Drs. C. Lo-A-Njoe and A.P. de Leeuw (complete scaling model)
Figure 10

When using the balanced approach we need insight into business processes, in order to understand what drives the business, for example let us discuss what a control department manager does with respect to ensuring that all financial reporting and forecasting is timely and accurate. So, to know how information is gathered and processed and the data in the system is correct we need some form of control over the management of different processes.

Given the entity's history and culture, combining hard controls and soft controls makes sense. We have to balance flexibility and structure, and use whatever works best. For some aspects of management control, hard controls work best. For others, relying on the culture and control environment works better.

Weighing flexibility and structure means that the best of both worlds is used. To understand which soft controls are likely to operate effectively, we need to point towards the strategy of the organization. "You have to find the soft controls that are embedded within the organization, using those aspects that

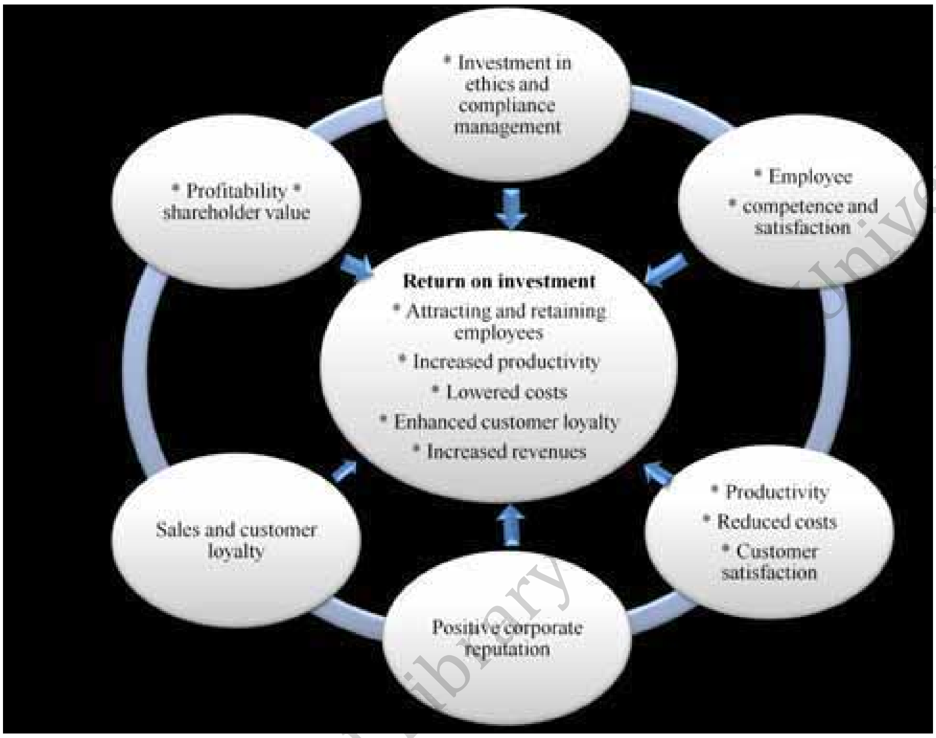
are understood and second nature to the firm, for example, if both honesty and Privacy are key strategic values for our entity. Therefore, everything we do is checked against these values and if anyone goes against these values, they will be corrected by their peers.

2.6.3. The Return on Ethics and Compliance and Importance of Communication in Ensuring Effectiveness

Fear of legal action, financial loss and reputational damage has inspired more entities to pursue ethics and compliance, but as a business process, ethics and compliance management also generates considerable positive value. Entities have more satisfied, more productive, lower risk employees, and customers are more likely to buy their products and services. Statistics in USA say that seven out of ten Americans have decided against purchasing products or services from an entity because of questionable ethics[3]. Employees are similarly unresponsive to unethical behavior. Those who believe management endorses unethical conduct often disobey orders and instead do what they believe is right, and 80 percent of them would not recommend their entity to recruits. Even best intentions mean little if employees are not educated properly. Among entities with all types of attitudes towards ethics, poor training is a leading cause of reporting and compliance failures.

The honorable ethics and compliance cycle makes a good starting point for communicating the importance of and gaining buy-in to an ethics and compliance program internally because it answers a basic question: How does this benefit me? Figure 11 illustrates that for employees, improved entity and business-unit performance increases compensation and creates opportunities for promotion; for management teams and boards of directors in mature markets, effectively managing ethics and compliance is becoming a cost of staying competitive. The place to start with ethics and compliance communication is at the top. Managers, supervisors and executives will always be the cornerstone of successful ethics and compliance management. If management does not demonstrate a commitment to ethics and compliance, no employee will be inspired to care either.

[3] LRN, "New Research Reveals Business Impact of Ethics, Signals the Importance of Ethical Corporate Cultures," press release, 30 January 2006, http://www.lrn.com/news/newsandevents.php (February 17, 2006)



The Return on Investment in Soft Controls
Source: Prepared by the Researcher
Figure 11

2.6.4. Tactics to Communicate the Importance of Ethics to Employees

- **Create a communication plan that identifies audiences, objectives and messages.**
  Ensure that messages address cultural, regional, industry and entity specific questions. In other words, how ethics and compliance will keep employees out of trouble and help their careers. Make the communication plan relevant to the overall corporate strategy in place, so the ethics and compliance messaging is clearly rush into the larger picture.

- **Plan for a roll-out across as many media as possible that continues in some form indefinitely.**
  Use multiple platforms, such as e-mail, posters, cafeteria table tents, pay envelopes, intranet banner ads, and live events to meet the basic rule of advertising

- **Use consistent branding, including the entity logo.**
Create an easily identifiable look for ethics and compliance training and communication in order to remind employees who are not paying attention that the entity regularly addresses ethics and compliance and therefore takes it seriously. Don't forget to include the entity logo, which many employees use as an indicator for whether or not something is important.
- **Weave ethics and compliance into regular communications.**
Show that ethics and compliance management is integral to entity strategy and let employees convince themselves of its importance. Build ethics and compliance into new product or strategy presentations, allowing employees to make their own connections between personal goals and ethical behavior. If a sales meeting treats ethics only in a stand-alone presentation, employees will naturally think of ethics as standing apart from sales strategy.
- **Make an emotional appeal.**
Balance fairness and the desire to be a good person. Demonstrate the serious consequences of violations with real-world examples from entity history and the news. Tap sources of loyalty or nostalgia, such as a popular CEO, historical roots, to lift employees out of their short-term mindset into a sense of long-term purpose. Reward good behavior with incentive and internal award programs that recognize sound ethical decision making.

2.7. Corporate Governance and Soft Controls

The public image of an entity will quite accurately reflect the culture of its body. Good corporate governance has to be in the bones and bloodstream of the organization since this will be reflected in the culture. To carry the correlation further, in the same way that healthy blood and bones are reflected in the healthy look of a person, so an organization whose internal functions are healthy will naturally look so from an external perspective.

Corporate governance could be defined in different ways, the widely used definition is "the system by which entities are directed and controlled" (Cadbury Committee, 1992 page 14). More specifically it is the framework by which the various stakeholder interests are balanced, or, as the international finance corporation IFC states, it is "The relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders".

The organization for economic co-operation and development OECD principles page 13, define corporate governance as involving "a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy."

The Basel committee, page 13 defines corporate governance as it is "involves the allocation of authority and responsibilities, i.e. the manner in which the business and affairs of an entity are governed by its board and senior management, including how they:

1. Set the bank's strategy and objectives;
2. Determine the bank's risk tolerance/appetite;
3. Operate the bank's business on a day-to-day basis;
4. Protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognized stakeholders; and
5. Align corporate activities and behavior with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations"

Effective corporate governance practices are essential to achieving and maintaining public trust and confidence in entities, which are critical to its proper functioning and to the economy as a whole. Poor corporate governance can contribute to failures and bankruptcies, for instance it can pose significant public costs and consequences due to their potential impact on any applicable deposit insurance system and the possibility of broader macroeconomic implications, such as contagion risk and impact on payment systems. This has been illustrated in the financial crisis that began in mid-2007.

In addition, poor corporate governance can lead markets to lose confidence in the ability of an entity to properly manage its assets and liabilities, including deposits as this happen in banks, which could in turn trigger a liquidity crisis. In addition to their responsibilities to shareholders, Indeed it has been said that corporate governance consists of two elements:

1. The long term relationship which has to deal with checks and balances, incentives for manager and communications between management and investors;
2. The transactional relationship which involves dealing with disclosure and authority.

This implies an adversarial relationship between management and investors, and an attitude of mutual suspicion. This was the basis for much of the rationale of the Cadbury Report[4], and is one of the reasons why it prescribed in some detail the way in which the board should conduct itself: consistency and transparency towards shareholders are its watchwords.

Corporate governance therefore is a system of structuring, operating and controlling an organization to achieve the following:

- A culture based on a sound business ethics
- Fulfilling the long-term strategic goal of the owners while taking into account the expectations of all the key stakeholders, and in particular:
  - consider and care for the interests of employees, past, present and future
  - work to maintain excellent relations with both customers and suppliers
  - take account of the needs of the environment and the local community
- Maintaining proper compliance with all the applicable legal and regulatory requirements under which the entity is carrying out its activities

2.7.1. The Importance of Corporate Governance

Globalization has vastly increasing the scale of trade and the size and complexity of entities, the importance of corporate governance has been amplified as it becomes increasingly difficult to regulate externally.

[4] The **Cadbury Report**, titled Financial Aspects of Corporate Governance, is a report issued by "The Committee on the Financial Aspects of Corporate Governance" chaired by Adrian Cadbury that sets out recommendations on the arrangement of entity boards and accounting systems to mitigate corporate governance risks and failures. The report was published in draft version in May 1992. Its revised and final version was issued in December of the same year. The report's recommendations have been used to varying degrees to establish other codes such as those of the European Union, the United States, the World Bank etc...

Here, three issues will be explored which are considered key in understanding the importance of corporate governance:

Integrity – the perception of the word integrity differs between corporate governance observers, while it is called honesty, ethical, and fairness as a technical term for accountants, lawyers etc., however the adverse names of honesty and ethics or those questionable practices are called by the general public as rip-off, cheating and crooked.

The central issue today therefore in the field of corporate governance is not whether most listed entities comply with the various provisions of laws and regulations; the key point is whether the top management of large organizations is seen as possessed of integrity in the eyes of the general public. This is the spirit that gave support to the principle of setting up the Cadbury Committee, and Sarbanes-Oxley act and other laws and regulations. It is not simply a matter of laying down some rules on the financial aspects of corporate governance to prevent innocent fund managers being misled by greedy directors. It is this integrity - perceived and actual - which underlines the importance of corporate governance, as it is the tool by which integrity can be encouraged, measured and projected.

Along the talk about integrity we have to know more about business ethics which are in this context the very bloodstream of the organization. The trouble with much of the debate about corporate governance is that it looks on it as a separate discipline, a series of boxes to be ticked, including ensuring that the business is perceived to be ethical. Often this results in the annual statements external accounts about all the initiatives the entity funds, participates in or supports in other ways. Worthy as these initiatives may be, in our corporate governance view, is at least as much (or more) about the perception than a real commitment to running the business ethically. To do this requires business ethics to spread through the whole organization – including/especially the recruitment process – and have measures in place to catch questionable practices.

In this way it is much less likely that people with malicious intent or susceptible natures will survive in the organization, because such behavior will be picked up and fed back – crucially, independently – to senior management and the board, via the compliance officer or the legal counsel. As the famous saying goes, the fish rots from the head, so this requires complete commitment from the board not only to the principles of business ethics but to the measurement and benchmarking of ethical performance.

The Bonus Culture

The current financial crisis has brought into sharp focus the system of bonuses and remuneration operated by financial institutions. It is argued that it encouraged excessive risk taking and irresponsible lending. Combined with the complex financial instruments that the mainstream institutions constructed to move the risk off their books, this was what led to the so called 'credit crunch'. What is certainly true is that there was excessive risk and irresponsible lending and this led to the downfall of some of the world's biggest lenders and in turn the insurers insuring that risk.

The importance of corporate governance in this scenario is unquestionable. A better system of checks and balances (the core definition of corporate governance) would have picked up the warning signs that many people were sending that the level and criteria of lending was getting dangerous. The OECD have published lessons from the financial crisis, which also conclude that "the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements which did not serve their purpose to safeguard against excessive risk taking in a number of financial services entities."

The researcher strongly believes that the corporate governance approach would have succeeded if it has placed corporate governance and business ethics at the core of the organization not as a separate issue.

Directors' pay and the bonus culture are often seized upon by special interest groups and the media as a single issue, not in the context of business and society as a whole, and is therefore blinkered to the underlying factors causing and affecting remuneration. While the latter is an obvious manifestation of good or bad governance (if only because it exposes the quality of stakeholder communication!), it misses the basic point that entities should be run well and responsibly - in *every* way, not simply in how they pay salaries and bonuses. In a well run entity, good performance is rewarded and rightly so - to attract talent and people dedicated to improving performance, not simply doing a job.

In its Principles of Corporate Governance, the OECD acknowledges that: "Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the entity and its shareholders and should facilitate effective monitoring." Clearly, it is not in the best interests of the entity for it to go out of business or be bailed out by governments. So it is not the *principle* that should be debated here, but the *implementation*. As we said earlier, while the board, management - and even

the shareholders - may feel that remuneration is fair, it is clear that current corporate policy is not in line with public perception.

Directors' Training

An outcome to the focus on corporate behavior and the behavior of senior corporate employees is the attention increasingly being paid to the qualification of these senior people to carry out their responsibilities. There has never been any formal qualification required to run an organization, and none to be a director. In practice, most large and well run organizations will look for suitable professional qualifications in their senior staff, and there are an increasing number of organizations offering non-executive director training and selection services.

In the last ten years or so, especially following the dot com boom and the collapse of Enron and WorldCom, the role of direction has finally begun to be seen as a profession or at least a discipline requiring specific training and development. It is clear that it is the importance of corporate governance has been a major influence here.

To make a real difference long term, it should start much earlier in professional development, and corporate governance is starting to filter down, with some MBA courses, especially in Australia, offering it as part or all of the course content. Others, such as the London Business School, include modules on ethics and Corporate Social Responsibility.

It is my sincerest hope that this trend continues and that the true importance of corporate governance is fully recognized and acted upon worldwide.

2.7.2. Principles and Rules of Corporate Governance

From our early discussion it is clear now that the correct approach to corporate governance is based on two fundamental concepts:

- The business morality or ethics must permeate the entire operation from top to bottom and embrace all stakeholders
- Good corporate governance is an integral part of good management practice also permeating the entire operation, not a separate issue addressed by auditors etc.

This approach recognizes that the interests of different stakeholders carry different weights, but this does not, by any means, suggest that those with a major interest matter and the rest don't. On the contrary, best corporate governance practice dictates that all stakeholders should be treated with equal

concern and respect. This approach dictates the truly respect of minority interests like constitutions do.

In the following paragraphs it will be discuss the principles and rules of corporate governance, although this discussion is pretty enough to clear the standing point of corporate governance.

2.7.3. Principles of Corporate Governance:

1. **Ethical approach** - culture, society; organizational paradigm
2. **Balanced objectives** - congruence of goals of all interested parties
3. **Each party plays his part** - roles of key players: owners, directors, and staff
4. **Decision-making process** in place - reflecting the first three principles and giving due weight to all stakeholders
5. **Equal concern** for all stakeholders - even though some have greater weight than others
6. **Accountability and transparency** - to all stakeholders

Best corporate governance practices are not simply about a battle between distant, disloyal institutional shareholders and greedy directors but about the culture of the organization and fulfilling its clearly agreed goals.

These goals may be set by the entrepreneur who starts the business, but they are accepted by all parties as being high-minded and in everyone's interests. In spite the fact that some parties have bigger stakes and some benefit more than others, and different parties want different things from the entity. There has to be, therefore, a process of identifying the different needs and, as much as possible, harmonizing them. This is the starting point for the smooth running of the business. Once disagreements in the common goal creep in, the danger of the standard of corporate governance deteriorating rises steadily.

2.7.4. Rules of Corporate Governance:

1. **Business Ethics**: a clearly ethical basis to the business.

2. **Align Business Goals**: appropriate goals, arrived at through the creation of a suitable stakeholder decision making model
3. **Strategic Management**: an effective strategy process which incorporates stakeholder value

4. **Organization**: an organization suitably structured to effect good corporate governance
5. **Reporting**: reporting systems structured to provide transparency and accountability

1. **Business Ethics** – In a world disillusioned with globalization, the importance of business ethics is greater than ever. Business needs to be truly acting in a way which goes beyond purely profit-based motivations, towards a model which works for everyone – what we call the Triple Bottom Line: People, Planet, and Profit. An ethical approach is fundamental to sound business practice, so business morality or ethics must spread through an organization from top to bottom and embrace all stakeholders.

Factors Highlighting the Importance of Business Ethics

- **Long-Term Growth**: sustainability comes from an ethical long-term vision which takes into account all stakeholders. Smaller but sustainable profits long-term must be better than higher but riskier short-lived profits.

  Large profits are always attractive, potentially allowing faster achievement of strategic goals, a greater provision against risk and a greater sense of success and stability. One can only hope that the heads of such organizations recognize the importance of business ethics and the resulting need to change to a more sustainable model of growth.

  Fundamentally the importance of business ethics is driven by personal ethics and morality and most people are fundamentally self-interested. But, if it is in people's best interest to be ethical, this has the potential to drive real change. It is already happening in several consumer markets where demand is shifting to ethical products and social networks are instrumental in spreading stories about unethical practices.

- **Cost and Risk Reduction**: entities that recognize the importance of business ethics will need to spend less protecting themselves from internal and external behavioral risks, especially when supported by sound governance systems.

  Let us take the Quality Management industry. In the early 1980s products began to be inspected before leaving the factory in an attempt to reduce the amount of costly customer complaints. Now,

most products come with at least a one-year warranty and in the case of some car manufacturers, up to five years. In fact, what has started off as a self-interested need to reduce costs has led to more reliable products.

Another comparison comes from wider society. Just as widespread bribery and corruption in society which are recognized as being inimical to the development of a healthy economy, similarly the lack of a high standard of ethical behavior in a entity is inimical to trust and loyalty, which in turn has a detrimental effect on the health of the entity over the longer term.

It may be argued that an owner can run a business in whichever way he or she wishes, and at first glance there would appear to be a case for this so long as no other shareholders are involved, and only his money is at risk. The fact here is after many years of observing different standards of behavior in different business circumstances, one recognizes the relationship between the perception of ethics which spread through a firm and the degree of trust and loyalty present among employees and between staff and management. The conclusion one reaches is that loyalty and trust have a significant value in terms of the efficiency and effectiveness with which a business can be run, and the concomitant cost of control systems needed.

In other words, a highly ethical operation is likely to spend much less on protecting itself against fraud and will probably have to spend much less on industrial relations to maintain morale and common purpose. This should be motivation in itself to recognize the importance of business ethics and instill good corporate governance in any firm.

- **Limited Resources**: the planet suffers from scarcity of resources but a growing population; without ethics, those resources are fully supplied for purely individual gain at huge cost both to current and future generations.

Scarcity of resources is an irrefutable fact is that this planet. Probably the biggest failure in human development over the last three hundred years has been in recognizing that and attempting to minimize use and maximize re-use and recycling. This applies not only to specific environmental and sustainability issues but to corporate governance generally and the importance of business ethics to the new high growth regions and entities.

2. **Towards a Common Goal -** Align Business Goals – There are two main dangers in failing to align business goals:

- **Lack of a Common, Clear Goal and Strategic Direction**. This leads at best to inefficiencies and at worst business failure as decisions become increasingly difficult, especially in reacting to competitive pressure.
- **Dissent Among Stakeholders**. If the majority of interested parties in a business are not aware (due to a lack of effective corporate communications) or disagree with the board's view of the business goal, there are likely to be difficulties with stakeholder relations which can disrupt the smooth running of the business.

3. **Strategic Management –** We cannot emphasize strongly enough the importance of strategic management in good corporate governance (remember good governance = good management). In fact, I believe corporate governance should be an *integral part* of the strategy process.

By this it is meant that the entity is organized and run according to rules which

- set a goal which matches the duly considered expectations of the stakeholders
- work out a feasible strategy to achieve that goal
- put in place a firm which can carry out the strategy and attain the goal
- set up a control and reporting function to permit management to drive the firm effectively and make necessary adjustments to the strategy or even the goal

Anything less rigorous than the above strategic management definition will only achieve success by accident and will be vulnerable to all kinds of unexpected events.

As Harvey MacKay said: "Failures do not plan to fail; they fail to plan" (based on an old military proverb). And Thomas Edison famously said: "Good fortune is what happens when opportunity meets with planning." Examine any successful business and you will observe the high and disciplined level of planning which incontrovertibly led to that success – and the world is full of failures who failed to plan. Even many that have subsequently failed often did so because the importance of strategic management within the firm diminished and with it the essential structure and visibility required to achieve goals and avoid pitfalls.

4. **Organizational Effectiveness** – Organizational effectiveness should not be seen as a goal in itself but rather the means to an end - achieving your goals. Since our definition of corporate governance is in essence about good management, it follows that to achieve your goals, through the implementation of an ongoing strategic management process, requires an appropriate and effective firm.

   With an inappropriate organization in place, the goal will not be achieved, and the approach to business will be vulnerable to a falling short in ethical behavior. Furthermore, any relationship between the way the business is being run and the expectations of the various non-managerial stakeholders will be purely coincidental.

   Before embarking on change to improve organizational effectiveness we must first understand where we are now and where we want to get to. This once again highlights the importance of strategic management (the third rule).

5. **Corporate Communication**

   Corporate communication rule focused on there being an ethical approach to running the business, the need to align business goals, to have an effective strategic management process in place and an effective firm capable of delivering the strategy and achieving the agreed goals. The underlying importance of corporate communication in all these rules is clear. From finding out what our stakeholders think of the entity (including how good our communication is!) to disclosing full details of how it is run e.g. directors' remuneration, communication plays a vital role throughout.

   In this Fifth Rule, we are looking at setting up channels of communication and how these channels – and the reporting system as a whole (i.e. including internal, operations monitoring) - should be used to

   - ensure all stakeholders are happy with the proposed strategy
   - monitor progress from point A to point Z in the strategy
   - ensure that stakeholders are receiving all the information they require

From the above mentioned discussion we would conclude that the importance of corporate communications is not necessary purely to the need to protect the public face of the entity but more fundamentally, to the smooth running of the entity - specifically the delivery of the strategy and goals of the firm. We can

conclude also that various similarities between corporate governance and soft controls are there; this could be summarized as follows in Table 2-3:

Table 2-3: Similarities between Corporate Governance and Soft Controls

Subject Matter Item	Explanation
Corporate governance concept	ethical approach – culture, society; organizational paradigm
Balanced objectives	Congruence of goals of all interested parties
Each party plays his part	Proper assignment of responsibilities Making processes and ownership, as if in possession of the key players
Decision-making process	Decision making process plays to full interest of the entity as it balances between risk and return
Equal concern	Everybody in the entity or has to do with the entity is treated equally, even though some have greater weight than others
Transparency	All entity's stuff is managed in a transparent manner, so no illusionary figures or situation is being released
Accountability	Accountability mechanisms to ensure that people feel accountable to the entity as a whole, rather than a particular individual
Sustainability	Comes from an ethical long-term vision which takes into account all stakeholders
Long run vision	Smaller but sustainable profits long-term must be better than higher but riskier short-lived profits
Cost and risk reduction	Entities that recognize the importance of business ethics will need to spend less protecting themselves from internal and external behavioral risks, especially when supported by sound governance systems
Limited resources	Business ethics recognize that planet has scars resources but a growing population; without ethics, those resources are fully supplied for purely individual gain at huge cost both to current and future generations, frauds get increasing otherwise
Board composition	Encourage creating a climate of trust and honesty, fostering a culture of open dissent, utilizing a fluid portfolio of roles, ensuring individual accountability, and Evaluating a board's performance

Source: Prepared by the Researcher

The above table shows with no doubt those soft controls are the driver of corporate governance, and wherever entities seek for success, they have to adopt soft measures to sustain that success. Again many have defined corporate governance accordingly as "Management control with integrity" and "Compliance, integrity and value creation"

A good way to summarize might be to quote what the finance directors fed back on a corporate governance workshop that has been conducted in joint

effort between educational and professional parties in UK. These quotes summed up the key messages that are coming through from all sides on this issue:

In response to the question: How far does corporate governance reach i.e. what is the legitimate range of activities that corporate governance might cover? The FDs said:

"Corporate governance reflects all aspects of the whole organization"
"Corporate governance covers the entire culture of an organization"

In response to the question: Does corporate governance promote short-termism or can it enhance shareholder return through increased accountability, disclosure and transparency? The FDs said:

"Risk of non compliance or poor governance reduces trust – good governance is the key to future prosperity"

"Good corporate governance promotes value creation, reputation, and profits"

2.8. Ethics in Civilizations

We cannot say that business ethics is a recent phenomenon originated with the emergence of institutions, whether entrepreneur or cross-border entity, on the contrary the work ethics was born with the birth of man as a socialized being that was in need for commercial exchanges since his inception. Therefore when we discuss soft controls – which are mainly a moral based concept, we should consider the moral aspects that God has put in the human being that are considered driver of the man behavior in the surrounding community in which he lives.
Therefore, we must address the issue of soft controls in the three monotheistic religions given its importance in clarifying that the ethical values is a prerequisite requirement for the existence of the man kind and it is not a complementary requirement of being, and to point out that the culture that God has built people on since their inception is based on a moral ground which did not at all prevented improving the life, rather it has determined the path of righteous deeds in all actions including those involving business. The following paragraphs illustrate with no dubious that all religions emphasized the importance of ethical behavior.

2.8.1. Islamic Tenets Concerning Business Transactions

Islam has put pretty much focus on ethics and ethical behaviour, as long it demands a certain type of behaviour from the related parties of an economic transaction. The behaviour prescribed for the economic units of the society are so devised as to lead to a happy state of affairs, which is the ultimate goal of Islam. An Islamic market is characterized by certain norms that take care of the interests of both the buyer and the seller. The umbrella under which Islam transactions are managed is the Prophet Mohammad saying "Leave what makes you doubt for things that do not make you doubt". (*Tirmidhi*, No: 2442)

There are a number of rules of ethical discipline in Islamic commercial transactions without which business contract would be regarded as lacking perfection in the light of the code of good manners, decency and ethical excellence. Table 2-4 illustrates a non inclusive list of these tents:

Table 2-4: Islamic Tents of Business Ethics

Keenness to Earn Legitimate Earnings	Islam places great emphasis on the code of lawful and unlawful in business transactions. - Do not devour another's property wrongfully – unless it be by trade based on mutual consent. (4:29) - When the prophet is asked 'what form of gain is the best? [The Prophet] said, 'A man's work with his hands, and every legitimate sale'. (*Ahmad*, No: 1576)
Trade through Mutual Consent	A sale transaction is to be regarded as legal only if it is made through the mutual consent of the parties concerned. Taking advantage of someone's plight and charging high price is also a form of pecuniary exploitation and as such forbidden in Islam. - The Holy *Qur'an* says: "O you who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual goodwill: nor kill [or destroy] yourselves: for verily Allah has been to you Most Merciful." (4:29)
Truthfulness in Business Transactions	The Prophet Said: "The seller and the buyer have the right to keep or return the goods as long as they have not parted or till they part; and if both the parties spoke the truth and described the defects and qualities [of the goods], then they would be blessed in their transaction, and if they told lies or hid something, then the blessings of their transaction would be lost. (*Bukhari*, No: 1937)
Trustworthiness in Business	Trustworthiness is one of the most important principles of ethical discipline in commercial transactions. Says the Holy

Transactions	*Qur'an*: O you believers! Do not betray Allah and the Messenger, nor knowingly, betray your trusts. (8:27)
Honouring and fulfilling Business Obligations	Islam attaches great importance to the fulfilment of contract and promises. Islamic teachings require a Muslim trader to keep up his trusts, promises and contracts. The basic principles of truth, honesty, integrity and trust are involved in all business dealings. The Holy *Qur'an* emphasizes the moral obligation to fulfil one's contracts and undertakings. A verse states thus: O you who believe! Fulfil [your] obligations. (5:1) A tradition of the Prophet states thus: The Muslims are bound by their stipulations. (*Abu Da'ud*, No: 3120) Another tradition condemns promise-breaking as the hallmark or trait of a hypocrite: If he makes a promise, he breaks it, and if he makes a compact, he acts treacherously. (*Bukhari*, No: 32)
Fair Treatment of Workers	Islam encourages and promotes the spirit of love and brotherhood between employer and employees. It is the religious and moral responsibility of the employer to take care of the overall welfare and betterment of his employees. Fair wages, good working conditions, suitable work and excellent brotherly treatment should be provided to the workers. Prophet Mohammad said: "Those are your brothers [workers under you] who are around you; Allah has placed them under you. So, if anyone of you has someone under him, he should feed him out of what he himself eats, clothe him like what he himself puts on, and let him not put so much burden on him that he is not able to bear, [and if that be the case], then lend your help to him" B*ukhari*, No 2359 He also said: "I will be foe to three persons on the Last Day: one of them being the one who, when he employs a person that has accomplished his duty ,does not give him his due*"* *Bukhari* ,No 2109
Dealing in Prohibited Items	If Allah makes something unlawful, he makes its price also unlawful. (*Ahmad*, No: 2546)
Sale of *Al-Gharar* (Uncertainty, Risks, Speculation)	El-Gamal (2000, p.7) defines *Gharar as* "… the sale of probable items whose existence or characteristics are not certain, due to the risky nature which makes the trade similar to gambling". However, Al-Saati (2003) counters that there is no agreement among Muslim jurists about the degree of uncertainty in commercial transactions to be considered as *Gharar*. Iqbal and Molyneux (2005, p.14), for instance, suggest that "*Gharar* refers to acts and conditions in

	exchange contracts, the full implications of which are not clearly known to the parties. The holy Quran (2:188) said: “And eat up not one another's property unjustly (in any illegal way e.g. stealing, robbing, deceiving, etc.), nor give bribery to the rulers (judges before presenting your cases) that you may knowingly eat up a part of the property of others sinfully”
Arbitrarily Fixing the Prices	Islam grants absolute freedom to traders provided they adhere to the code of lawfulness. It does not, therefore, encourages the practice of price–fixing and leaves the traders to earn the profits from each other within the lawful limits. As a matter of principle public authorities are not allowed to fix the prices of commodities by force. This is because rise and fall in the prices are linked to various factors other than the greediness of the traders and fixing the prices may endanger both public and private interests**.** It is reported that people said to the Prophet: "O Messenger of Allah! Prices have shot up, so fix them for us. Thereupon the Messenger of Allah said: ‘Allah is the One Who fixes prices, withholds, gives lavishly, and provides, and I hope that when I meet Allah, none of you will have any claim on me for an injustice regarding blood or property". (*Tirmidhi*, No: 1235)
Cheating and Fraud in Business Transactions	The traders and businessmen generally have a tendency to motivate the customers by adopting fraudulent business practices. Islam strongly condemns all such practices in business transactions (*Al-Ghashsh*). The Messenger of Allah has commanded the believers not to indulge in cheating and fraudulent practices in business transactions. **Exploitation of one’s Ignorance of Market Conditions –** One of the most common unethical practices in modern business is to exploit one’s ignorance of market conditions. Sometimes it may happen that a buyer arrives in a town with objects of prime and general necessity for selling them in the market. A local trader may persuade the new-comer to transfer all of the goods to him so that he will sell them on his behalf in the market. He obtains the commodities on a price that is lower than market price and then sells them at a high or exorbitant price. Islam condemns this act of intermediary intervention which involves exploitation of one’s ignorance of market conditions. The practice was prevalent in pre-Islamic society. The Prophet prohibited this practice through a number of instructions. A tradition reads: “A town dweller should not sell the goods of a desert dweller.” (*Bukhari*, No: 2006)

	Trickery – This means any action in which a person offers a high price for something, without intending to buy it, but just to cheat or defraud another person who really means to buy it. The person practising it may collaborate with the seller to offer high prices in front of the buyers merely as a means to cheat them. This type of fraudulent transaction is totally prohibited in Islam. The Prophet is reported to have said: “Do not harbour envy against one another; do not outbid one another [with a view to raising the price]; do not bear aversion against one another; do not bear enmity against one another; one of you should not enter into a transaction when the other has already entered into it; and be fellow brothers and true servants of Allah.” (*Muslim*, No: 4650)
Swearing	The traders often take recourse to swearing to emphasize that their items are of good quality. They claim qualities in the merchandise, which don’t exist. They try to persuade the buyers to purchase their commodity by invoking Allah’s name. The Prophet is reported to have said: “Swearing [by the seller] may persuade the customer to purchase the goods but the deal will be deprived of Allah’s blessing.” (*Bukhari*, No: 1945)
Giving Short Measures	The prophet said: “And give full measure when you measure, and weigh with a just balance. That is good and better in the end.” (17:35)
Dealing in stolen goods	The Prophet made the person knowingly buying a stolen commodity a partner to the crime. He said: “The one, who knowingly purchases a stolen good, is a partner to the act of sin and the shame.” (*Kanz Al-‘Ammal*, No: 9258)

2.8.2. Ethics in Christian Religion

There are number of rules of ethical discipline in Christian commercial transactions without which business contract would be regarded as lacking perfection in the light of the code of good manners, decency and ethical excellence. Table 2-5 illustrates a non inclusive list of these tents:

Table 2-5: Christian Tents of Business Ethics

Fair Treatment of One’s Employees	"You shall not cheat your fellow and you shall not rob; the wages of a worker shall not remain with you overnight until morning." (Leviticus 19: 13)
Not Engaging in Dishonest and Immoral	"Thou shalt not steal." (Exodus 20: 13) "Distance yourself from a false matter." (Exodus 23:

Business Practices	7) "Do not accept a bribe." (Exodus 23: 8) "You shall not steal, you shall not deal falsely, and you shall not lie one to another." (Leviticus 19: 11) "You shall not cheat your fellow." (Leviticus 19: 13) "You shall do no unrighteousness in judgment… with righteousness you shall judge your fellow." (Leviticus 19: 15) "You shall not commit unrighteousness in justice, in measures of length, weight, or volume. Just scales, just weights, just dry measures, and just liquid measures you shall have." (Leviticus 19: 35-36)
Keeping Market Prices Stable	The Bible (Leviticus 25: 14) states: "If you sell something to your neighbor or buy something from your neighbor's hand, you shall not wrong one another."

2.8.3. Ethics in Judaism

Judaism plays a role in guiding Jewish business dealings. As all religion driven civilizations, Judaism is not limited to one's personal life it is related also to business interactions – buying, selling, investing, hiring, advertising, etc. – as a framework for spiritual growth and ethical fortitude. Table 2-6 illustrates a non inclusive list of these tents:

Table 2-6: Judaism Tents of Business Ethics

The Torah prohibits taking advantage of another person	When you buy or sell to your neighbor, do not cheat one another
The prohibition against 'taking advantage' applies to swindling one another, whether seller or buyer	"When you sell something to your fellow, or buy something from your fellow, do not take advantage of one another."
One may demonstrate the good qualities of his merchandise but not cover up its defects.	Anything that one does in order to demonstrate the good quality of the object is good and appropriate. However, what someone does to conceal the defects of what he is trying to sell constitutes trickery and is forbidden. This is an important general rule in business ethics.
This law applies even when one finds a better deal.	The correct opinion is that even if someone agreed to one price, and is then offered another, he should not back out of the original deal, and if he does he is considered lacking in integrity.

Torah Guide For the Businessman, pg. 11 – One should keep one's word even at the cost of financial loss	A verbal agreement is not legally binding according to Torah law. However, breaking a verbal agreement is considered a breach of trust. A promise to buy or sell should be upheld even if it will cause financial loss.

Chapter three

Literature Review

Table of Contents

There is no doubt that there are many studies that have been conducted globally focusing on the importance of soft controls. Moreover, universities, consulting firms, and external audit bodies have contributed in emphasizing the importance and impact of soft controls on the different internal control systems, examples of such institutions are Ernst & Yong, KPMG. The objective of this chapter involves the identification of the various published materials are of interest and gaining access to thesis. And to demonstrate that the problem investigated is perceived by the internal control practitioners' community as relevant and significant.

3.1. Overview of Relevant Studies on the Soft Controls.

1. *Ernst & Young (2012), Auditing Soft Controls Perspectives from Next Generation Internal Auditors.*
   The objective of the study is to prove that the behavioral auditing model has the capacity to strengthen knowledge about how people impact an organizations risk profile to head to a more progressive internal audit. Through an analysis of behavioral and cultural issues, this approach seeks to provide a fresh insight into current control problems. To achieve this objective, the study used the behavioral engineering auditing model (BEAM). The study reported the following results:
   - An organizations control environment is only as good as the behavior and culture of the personnel responsible for applying the controls.
   - Just having the best designed control process is not enough when people are prepared to bypass those controls because of work or performance pressure, results pressure or even ambivalence or cultural issues.
   - Culture is defined by behaviors so the best way to assess the control environment is to look at behaviors examples are: Delegations of authority are in place (the design is good), but if people don't escalate or act on breaches (the behavior is unwanted), then the control is not working and it won't work until the behavior changes; there are controls in place to prevent early revenue recognition but the control owner has a bonus target based on sales. The control may be designed well, but the control owner has an incentive to not perform the control.

2. *Chtiouia and Thiéry-Dubuissonb (2011), Hard and Soft Controls: Mind the Gap!*
   The objectives of the study are to show that controlling an organization cannot be limited to the formal aspects of control (hard controls) and that informal aspects (soft controls) are both tricky to define and complementary in order to cover the risks in the most suitable way. The research used an analytical approach for the possible interactions between informal and formal control. The study reached the following conclusions:
   - Formal and informal controls do coexist in today's systems of corporate governance, understanding the nature of the interaction between these two methods of control is a subject of debate amongst the researchers. It is therefore difficult to assert whether the use of one could replace or could complement the use of the other. The shift from hard to soft control is moderate by various criteria.

3. *The Institute of Internal Auditing IIA (2011) Auditing the control environment.*
   The objectives of the study conducted by the IIA are:
   - To provide guidance to internal auditors on:
     - The significance of the control environment;
     - How to determine which elements of the control environment should be addressed by engagements in the periodic audit plan?
     - How to scope, staff, and plan such engagements?
     - Which items to consider in performing related audit work, including evaluating and reporting deficiencies?

   The used the expertise efforts to design an audit program guidance. The study reached the following conclusions:
   - The control environment is the foundation of an effective system of internal control.
   - Most of the well-publicized failures (including not only Enron and WorldCom, but also the governance failures that led to the 2008 financial crisis) were, at least in part, the result of weak control environments.
   - In the absence of a demonstrably effective control environment, no level of "design and operating" effectiveness of controls within business and IT processes can provide meaningful assurance to stakeholders of the integrity of an organization's internal control structure.

4. *Roth (2011), Tone at the top,* published by the institute of internal auditing IIA.
   The objective of the study is to emphasize that those at the top should pay particular attention to the culture that exists within their organizations,

and "the corporate culture is the most powerful control in any organization," says Roth. The study used to collect information from 19 public firms through a questionnaire in order to reach the following results:

- "The root cause of every major control breakdown — Enron, WorldCom, Tyco, etc. is a weakness in the culture. More than anything else, stakeholders need assurance that the 'soft controls' that create and embody the corporate culture are sound."

5. *Darragh (2011), Internal Auditors Reminded to Check 'Soft' Controls,* published by the Institute of Internal Auditors.
   The objective of the study is to show that the practice guide aids reminding internal auditors about the significance of the control environment and walks internal auditors through how to conduct an assessment of that environment. The study used the methodology of taking the practice guide, titled "Auditing the Control Environment," as example, the guide is a compilation of lessons learned over the past several years about how fraud and financial failures get started. The research reached the conclusion that one of the key lessons is the realization that integrity, ethics, and management operating style have just as much to do with a company's control environment as do the traditional internal controls.

6. *Leeuw & Vrije (2008), weighing the importance of soft controls in information technology auditing and control*
   The objective of the study is to answer the question related to fact that organizations can be managed in many different ways, with equally different leadership styles. But how do these different organizational structures and management styles influence the ways in which management can control its organization, and manage its risks? The study used the methodology of assessing the IT control framework as part of a Sarbanes-Oxley readiness project. The research reached the conclusion that companies can benefit by using a combination of hard controls and soft controls in their IT departments, just as they would do for the rest of their organizations. While management chooses to lead their organizations in ways that work best with the particulars for their specific organization, IT auditors and consultants are often stuck to a 'best practice' framework.

7. *LRN www.LRN.com (2006), Ethics and compliance risk management.*
   The objectives of the study are to answer the following questions:
   - Does fostering a strong ethical culture through a sustainable process?

- Does handling the ethics and compliance management also addresses the newest and most pressing risks to companies? According to the Economist Intelligence Unit, reputation (which is a function of perceived ethicalness combined with performance) and compliance with regulations are the most open areas to risk facing business today. The study used the methodology of holding interviews, compile and interpret and analyze historical and current events to identify trends. Finally the study concluded that:
- It is clear that the decisions of investors, customers and employees in the United States and European Union now depend significantly on ethics and legal compliance. Ethics and compliance management provides an opportunity for companies to stay at the forefront of this long-term trend, while building shareholder value and increasing profitability.
- Because ethics and compliance management depends heavily on soft controls, an effective assessment of ethics and compliance risk must take into account employee behavior and organizational culture.

8. *Dallas Chapter of the Institute of Internal Auditors (1998-1999), Soft controls: A Dallas/Fort Worth Perspective.*

The objectives of the study are to:
- Determine how the concept of soft controls is incorporated
- Discover the approaches to soft control audits by Dallas/Fort Worth Audit Departments.
- Identify the actual methods used in auditing soft controls by Dallas/Fort Worth Audit Departments.

The study used an empirical through questionnaires to stand on some facts related to soft controls from internal audit point of view. The study reached the following conclusions:

- It is "Difficult to make management understand what soft controls are and how they can impact their area."
- "Middle management and line personnel are often the most difficult to convince regarding the value of soft controls."
- "Evaluating soft controls requires employees to have a high level of trust with the Audit Department. It is a slow, gradual process in a tightly run organization. Be patient and take heart in the small changes.

- Soft controls are something that will stay – not a passing fad. We as professionals must address items such as "people's integrity and ethical values, "the organization's commitment to competence, "management's philosophy and operating style", "understanding and management of risk", and "communication".

3.2. What Distinguishes this Study From Other Studies?

While the previous studies have compared between soft controls and hard controls, this study highlights the importance of soft controls role in the successful implementation of internal control systems. It compares between the components of the soft controls and the soft side implicitly and explicitly included into the corporate governance principles, in addition this study will lead to the fact that corporate governance is predominantly application of soft control in institutions. Furthermore, this study has considered soft controls as the basis on which cultures and civilizations are based.

This study will work to find common denominators between the systems of internal control and corporate governance through the provision of an analytical model and through theoretical research study based on survey questionnaire for different financial, it also goes beyond what is known business institutions touching those soft controls incorporated in what so said religion-based civilizations.

This study is being founded on data from the financial institution sector in Jordan, and to the best knowledge of the researcher it is considered the first of its kind in Jordan and the Arab word.

Furthermore, the author has its own contribution in this study by providing the fruit of his vast experience working in the internal audit and risk management and the training fields for more than 23 years.

Chapter Four

Research Methodology

Table of Contents

This chapter is intended to present the methodology employed by the study to achieve its objectives. The chapter discusses the sample and population, the data collection tool and how it was validated, and the variables of the research.

4.1. Population and Sample

The population of the study represents the Jordan banking system including the Central Bank of Jordan and those foreign banks which have active branches in Jordan. However, not all banks were receptive to the questionnaire while the response rate in other banks was less than the expected. 216 questionnaires were intended to be handed out, 64 of them have not been distributed because of the decline to receive the questionnaires or none returning the handed out questionnaires, the remaining number of questionnaires could not be collected because of respondents' availability issues. Nevertheless, 133 questionnaires have been collected. From statistical point of view, this number represents a large sample size. On the other hand, the targeted job titles are: head of departments (audit function, risk management, compliance function, and operations) in addition to other key four employees in each of the above activities.

As the banking system is composed of domestic banks and branches of foreign banks operating in Jordan. The sample is considered representative as it is composed of a sufficient number of both, further more the sample of respondents is composed of internal control practitioners, executive & middle management, and staff. In the next chapter a demographic analysis will be provided and a distribution of respondents will be available then.

4.2. Data Collection

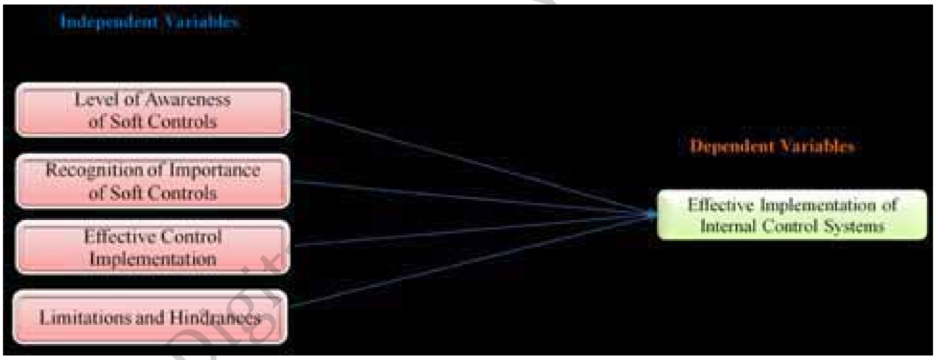
The research aims to stand on the effect of soft controls on the effective implementation of internal control systems. To satisfy this objective a questionnaire (appendix 7 shows the questionnaire format) has been developed to tackle the assessment of the four independent variables of the research. Therefore, the questionnaire has been divided into four categories with overall 59 questions to assist in measuring the four independent variables. The breakdown of the questions is: 17 questions to measure the awareness level in soft controls, 10 questions to measure the recognition of importance, 19 questions to measure the implementation of soft controls, and 13 questions to measure the limitations and hindrances facing the effective implementation. The used scale is the interval one in all the questions of the questionnaire, different scales (nominal and ratio) have been used in measuring the demographic questions.

4.2.1. Questionnaire Validation

The questionnaire has been validated internally and externally by different parties to ensure its reasonability, appropriateness, and span of coverage. Appendix 4 shows the questionnaire validation sources.

4.2.2. Variables of the Study

4.2.2.1. The independent/Dependent variables – the following diagram shows the main independent and dependent variables making up the study. However, the analysis encompasses other different variables that will be illustrated later according to its place in the statistical analysis.



The dependent variable is intended to be validated by examining the effect of the following factors on the dependent variable:

The strength of awareness level in soft controls
The sound and clear perception to the importance of soft controls
The effective implementation of soft controls
The potential limitations

The independent variables are being assessed through different measuring scales. Appendix 5 presents all used scales and their SPSS coding (codebook).

4.2.2.2. Controlling variables – it is noted however that the correlation between the independent – dependent variables does not always prove the causal effect between each of them, given that there is another

variable affecting this relationship, for instance there is a relationship between the high level of awareness in soft controls and their effective implementation, but there is another variable that contaminate this relationship which is "the positive control enhancers (good and rewarding internal control culture).

Different controlling variables have been analyzed in this study and will be presented thoroughly in the analysis section.

The following table shows examples of the controlling variables of the study:

1	The perceived positive enhancers of soft controls among the banking system
2	The perceived negative enhancers of soft controls among the banking system
3	The degree of involvement of the board and audit committees in evaluating the effectiveness of the "tone at the top" and taking steps to ensure its appropriateness

4.3. Analysis Techniques

- **Descriptive statistics** – it is used to analyze the demographic information and to prove the hold standing of hypotheses.
- **Correlations** – this will be done by reconstructing the scales under each of the main sections of the questionnaire and use them as new independent or dependent variables for the sake of the correlation analysis.

  The relationship between the variables identified among the correlations below was investigated using Pearson product-moment correlation coefficient. However, in interpreting the correlation values that fall between 0 and 1, in this research the suggested guidelines of Cohen (1988) will be considered:

R = .10 to .29	R = –.10 to –.29	Small
R = .30 to .49	R = –.30 to –.49	Medium
R = .50 to 1.0	R = –.50 to –1.0	Large

Two types of correlations will be calculated:

- Simple bivariate correlation (between two variables).
- Partial correlation while controlling for another variable.

- **Multiple Regressions -** are techniques used to explore the relationship between one continuous dependent variable and a number of independent variables or predictors. Multiple regressions are based on correlation, but allow more sophisticated exploration of the interrelationship among a set of variables (Julie Pallant, the SPSS survival manual, page 140).
  It can tell you how well a set of variables is able to predict a particular outcome. Multiple regressions can also be used to statistically control for an additional variable (s) when exploring the predictive ability of the model.
  Some of the main types of research questions that multiple regression can be used to address:
  - How well a set of variables is able to predict a particular outcome
  - Which variable in a set of variables is the best predictor of an outcome
  - Whether a particular predictor variable is still able to predict an outcome when the effects of another variable are *controlled for.*

  The standard multiple regression will be used in which all the independent (or predictor) variables are entered into the equation simultaneously. Each independent variable is evaluated in terms of its predictive power, over and above that offered by all the other independent variables (appendix 8 shows the assumptions of the multiple regressions.
- **Independent Samples T-Tests – it is a s**tatistical comparison between groups of data to test for significant differences between groups e.g. is there a significant difference in the mean soft control awareness scores for people who holds professional certificates and who does not? For this sake the independent-sample T-Test will be used (Appendix 8 shows the assumptions governing this comparison).

4.3.1. Checking the Reliability of the Scales

Reliability is One of the main issues concerns the scale's internal consistency. This refers to the degree to which the items that make up the scale 'hang together'. Are they all measuring the same underlying construct? One of the most commonly used indicators of internal consistency is Cronbach's alpha coefficient. Ideally, the Cronbach alpha coefficient of a scale should be above

.7. However, the Satisfaction with the research scales have good internal consistency, with Cronbach alpha coefficients reported as follows:

Awareness and acting	0.862
Recognition of importance	0.829
Control implementation	0.883
Limitations and hindrances	0.939

The degree of correlation of the item with the total score, Low values (less than .3) here indicate that the item is measuring something different from the scale as a whole. In fact the degree of correlation in general is as follows:

Awareness and acting	From 0.457 - 0.672
Recognition of importance	From 0.498 - 0.666
Control implementation	From 0.525 – 0.746
Limitations and hindrances	From 0.538 – 0.818

Chapter Five

Analysis and Results

Table of Contents

The objective of this chapter is to present the results of conducted analysis on the sample-subjects and to provide the appropriate conclusions and recommendations.
We will start first with analyzing the demographic information, and then we summarize the perception of respondents to each major section of the questionnaire (the questionnaire is composed of four sections that represent the independent variables of the study which are awareness level, Recognition of importance, Control implementation, Limitations and hindrances), the perception will be discussed in terms of mean and standard deviation). This will be followed by a presentation of the results of testing hypotheses process.

5.1. Analysis of Demographics

Table 5-6 below provides information about the sample of the study. From the table, it can be noted the following:

- 50% of the sample size is supposed to be executive positions; statistics show that only %16.55 occupies those positions, it seems that the employees who hold executive position are less responsive to such studies.
- While %66.9 of the respondents have total years of experience more than 10 years, %26.3 of them have experiences exceeding 20 years. It is noted that %73 of the respondents have little or moderate experience range from 1-10 years, %42.9 are of experience less than 5 years.
- Only %27.8 of the respondents have a hybrid experience in more than one local bank and %23.3 have experiences in local and foreign banks.
- The major of %54.8 of the respondents is accounting and business administration.
- %94 of the respondents hold bachelor degree or masters degree, the consecutive percentages are %60.9 and %33.1.
- %24.2 of the respondents are members of internal control related committees, and %35.3 of the respondents treat corporate governance matters.
- %34.6 of the respondents do not appreciate the role of internal control in their banks. It seems that the trust in the internal control role is undermined due to the weak implementation results.

Table 5-6 – Sample Demographic Information

Demographic Item	Criteria	Values		Mean	Std. Deviation
		No.	%		
Academic background	< bachelor's degree	6	4.5	2.316	0.5822
	Bachelor's degree	*81*	*60.9*		
	Master degree	*44*	*33.1*		
	PHD	2	1.5		
Professional background	None	*66*	*49.6*	2.541	2.896
	CPA	4	3.0		
	CIA	5	3.8		
	Any Risk Management Certificate	*12*	*9.0*		
	CFE	2	1.5		
	CICS	5	3.8		
	Others (B.S, PHR, CAMS, CCP, CICA, AIT, CMA, CRP, CRS, CBA, AML, CIB, CLBB, Diploma in Risk and Basel II, MIS, CIS, CCS, CFA, CISA, CFSA, CRP, CORE, CRCMP, IQA, FRM, CCT, IFRS, IAS)	18	13.5		
Job Titles	Board member	0	0	4.775	1.7196
	Executive manager	22	16.5		
	Internal control specialist	8	6.0		
	Risk management specialist	20	15.0		
	Internal auditor	37	27.8		
	Others (compliance, operations manager, credit officer, financial analyst, division head, accountant, dealer)	11	8.3		
Total years of experience	< 5	9	6.8	3.308	1.2979
	5 – 10	*35*	*26.3*		
	11 – 15	*30*	*22.6*		
	16 – 20	*24*	*18.0*		
	> 20	*35*	*26.3*		
Total years of experience in the current position	< 5	*57*	*42.9*	2.061	1.2634
	5 – 10	*40*	*30.1*		
	11 – 15	15	11.3		
	16 – 20	7	5.3		
	> 20	12	9.0		
Specialization Field	Accounting	*49*	*36.8*	2.631	1.6241
	Business Administration	*24*	*18.0*		
	Finance	15	11.3		
	Banking	10	7.5		
	Others	32	24.1		
The respondent is of hybrid experience	None	65	48.9	0.744	0.8133
	In more than one bank	*37*	*27.8*		
	Mix of domestic and foreign banks	*31*	*23.3*		
Extent of appreciation to	Yes	87	65.4	1.346	0.4774

Demographic Item	Criteria	Values		Mean	Std. Deviation
		No.	%		
the internal control role	No	*46*	*34.6*		
Being a member of internal control related committee	Yes	*33*	*24.8*	1.752	0.4336
	No	100	75.2		
Treating corporate governance matters	Yes	*47*	*35.3*	1.647	0.4798
	No	86	64.7		

5.2. Perception of Respondents to the Main Sections of the Questionnaire (Independent Variables)

This research is based on four question categories which are the awareness level of soft controls, the recognition of importance of soft controls, the level of implementation of soft controls, and the limitations of soft controls.
The overall conclusion from the analysis conducted on the responses of questions under each of these categories shows that consistency is there between the responses on the questions of level of all four categories.

The following sections illustrate distinctively, the result of analysis of the above mentioned four categories of question, supported with chart layouts indicating the linearity of all means and standard deviations of questions belonging to every and each category.

5.2.1. Awareness Level of Soft Controls

Table 5-7 below shows the means and standard deviations of all 17 questions within the category. From the analysis below it is clear that the overall mean is **3.98**, and there is no noted dispersion in the

standard deviation of category items. Chart no. 1 shows the linearity of the mean and standard deviation of all responses.

Concerning question number A15, it is a negative question where results have been reversed. Given so, the response on the question lays in consistent manner with the responses of the other 16 questions. In addition all responses lay between disagreement 2 and full agreement 4.9.

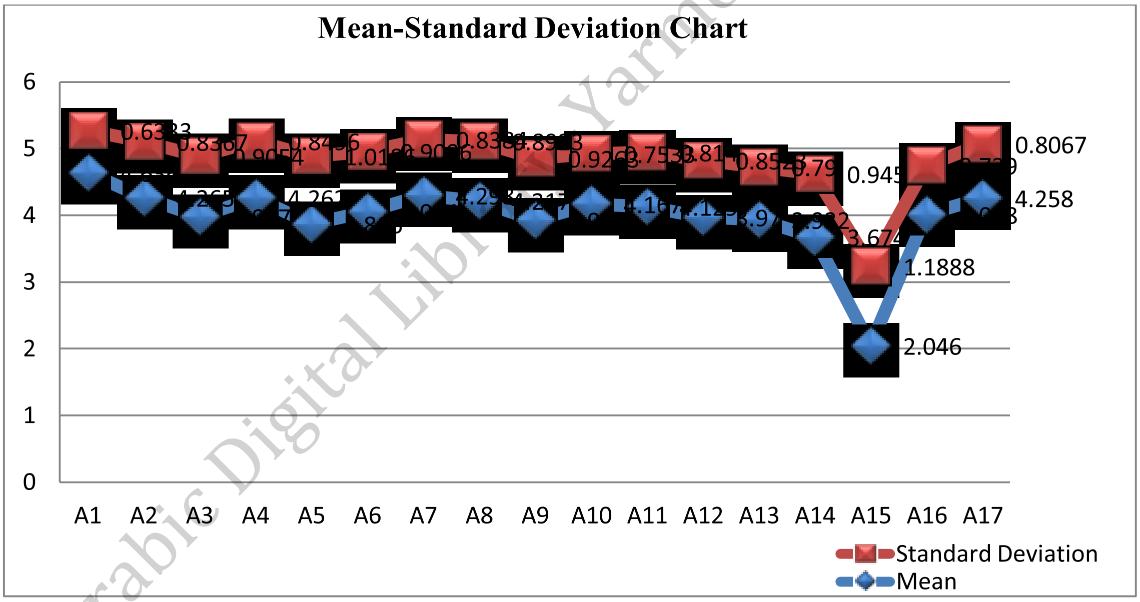


Chart 1

Table 5-7: Means and Standard Deviations of Awareness Level

S.	Awareness Level	Mean	SD[5]	Min.	Max.
A1	Extent of considering People's integrity and ethical values to play a role as a soft control	4.636	0.6333	1.0	5.0
A2	Extent of considering Management's philosophy and operating style as a soft control	4.265	0.8367	1.0	5.0
A3	Extent of Considering Approvals/Authority Levels as a soft control	3.977	0.9054	1.0	5.0
A4	Extent of Considering Segregation of duties as a soft control	4.262	0.8496	1.0	5.0

[5] SD: Standard Deviation

S.	Awareness Level	Mean	SD[5]	Min.	Max.
A5	Extent of Considering Reconciliations as a soft control	3.866	1.0186	1.0	5.0
A6	Extent of Considering Performing control self assessment as a soft control	4.054	0.9006	1.0	5.0
A7	Extent of Considering Responsibility and accountability as a soft control	4.298	0.8384	1.0	5.0
A8	Extent of Considering Commitment to competence as a soft control	4.217	0.8923	1.0	5.0
A9	Information on soft controls is communicated effectively and clearly both up and down within my department and across other areas	3.925	0.9263	1.0	5.0
A10	My company's code of conduct and other policies regarding acceptable business practice, conflicts of interest, and expected ethical standards of ethical and moral behavior are comprehensive and relevant and address matters of significance to me	4.167	0.7533	2.0	5.0
A11	Employees in my department fully and clearly understand what behavior is acceptable and unacceptable under the bank's Code of Conduct and know what to do when they encounter improper behavior	4.129	0.8140	2.0	5.0
A12	Soft controls are an integral part of the dominate culture in my bank	3.970	0.8523	1.0	5.0
A13	Outside parties understand my bank's ethical and behavioral standards and the ethical behavior basis on which my bank expects those parties to execute their deals with it	3.932	0.7900	2.0	5.0
A14	In my bank, internal auditors and risk people assess employees' understanding and compliance with soft controls by holding interviews with them, by observation, or through questionnaires or any other relevant methods	3.674	0.9450	1.0	5.0
A15	I think my bank's core beliefs are just words people use	2.046	1.1888	1.0	5.0
A16	The level of integrity of people in my department is getting better overtime	4.008	0.7390	1.0	5.0
A17	My organization's reputation in my community is remaining steady	4.258	0.8067	1.0	5.0
	Overall	**3.98**	**0.4807**	**2.0**	**4.9**

5.2.2. Recognition of the Importance of Soft Controls

Table 5-8 below shows the means and standard deviations of all 10 questions within the category. From the analysis below it is clear that the overall mean is **3.933** and there is no noted dispersion in the standard deviation of category items. Chart no. 2 shows the linearity of the mean and standard deviation of all responses.

In addition all responses lay between disagreement 2.2 and full agreement 5.

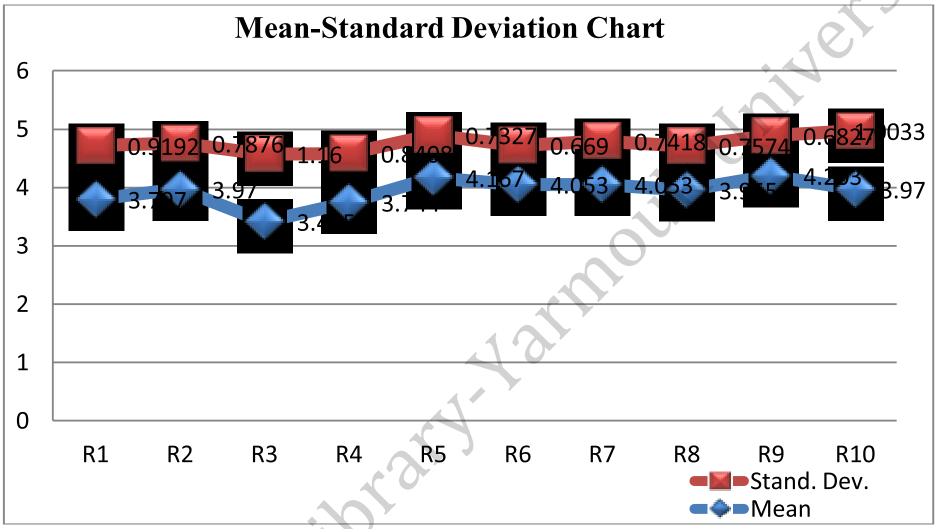


Chart 2

Table 5-8: Means and Standard Deviations of Recognition of Importance

S.	Recognition of Importance Level	Mean	SD	Min.	Max.
R1	I believe that any failure in the functionality of "soft" controls are the root causes of the subsequent failure in "hard" controls	3.797	0.9192	1.0	5.0
R2	Top management frequently communicates the importance of soft controls such as integrity and ethical behavior by all possible means	3.970	0.7876	1.0	5.0
R3	My bank emphasizes soft controls when it comes to directly investigate cases of fraud and occupational abuse	3.415	1.16	1.0	5.0
R4	Top management thinks soft controls are real controls, and it heavily relies on them	3.744	0.8408	1.0	5.0
R5	Employees in my department understand what behavior is acceptable and what behavior is considered unacceptable	4.167	0.7327	2.0	5.0
R6	Employees in my department know what to do when they encounter improper behavior given the importance of ethical behavior	4.053	0.669	2.0	5.0
R7	In my opinion, managers and employees in my bank show high level of commitment to competence, and they demonstrate that by having the adequate knowledge, competence, experience and training necessary to fulfill their assigned responsibilities	4.053	0.7418	2.0	5.0

S.	Recognition of Importance Level	Mean	SD	Min.	Max.
R8	As the attitude of management toward risk is part of soft controls aspects and it sums up its operational philosophy. Managers in my bank move carefully, proceeding only after analyzing the risks and potential benefits of ventures	3.955	0.7574	2.0	5.0
R9	Top management's commitment to integrity and ethical behavior in its day-to-day activities is essential for the effective implementation of internal control system across the bank	4.203	0.6827	2.0	5.0
R10	The existence of the bank's Code of Conduct and the consequences of its breach are an effective deterrent to unethical behavior	3.970	1.0033	1.0	5.0
	Overall	**3.933**	**0.5269**	**2.2**	**5.0**

5.2.3. Implementation of Soft Controls

Table 5-9 below shows the means and standard deviations of all 19 questions within the category. From the analysis below it is clear that the overall mean is **3.736**, and there is no noted dispersion in the standard deviation of category items. Chart no. 3 shows the linearity of the mean and standard deviation of all responses.

Concerning question number C12, it is a negative question where results have been reversed. Given so, the response on the question lays in consistent manner with the responses of the other 18 questions.

In addition question no. 2 shows inconsistent mean and standard deviation; however this does not mean anything in terms of perception of individuals about the implementation of soft controls, as long the response on this question depends on the result of the previous question, it is in fact for statistical purpose only.

In addition all responses lay between disagreement 2.2 and full agreement 4.8.

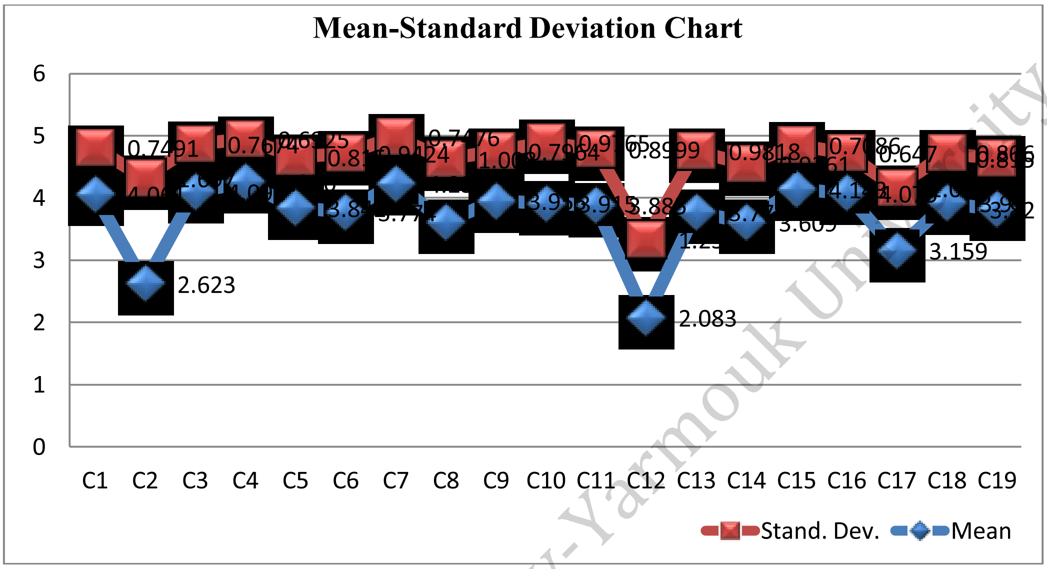


Chart 3

Table 5-9: Means and Standard Deviations of Control Implementation

	Internal Control Implementation	Mean	SD	Min.	Max.
C1	In my department, people usually implement appropriately soft controls	4.061	0.7491	1.0	5.0
C2	If your answer to the previous question was "I strongly agree" or "I agree", please answer the following question: Does implementation of soft controls started after the request of senior management and/or the board of directors?	2.623	1.697	0.0	5.0
C3	Managers at all levels do not ignore any sign of inappropriate behavior, on the contrary, they take it seriously	4.098	0.7674	2.0	5.0
C4	My bank adopts and promotes a culture of integrity, including ethics, business practices and human resources evaluations	4.256	0.6925	2.0	5.0
C5	Soft control procedures described in policy and procedure manuals are actually applied the way they are intended to be applied and relate clearly to identified risks	3.842	0.815	1.0	5.0
C6	Mechanisms exist to effectively collect and investigate information related to soft controls like business ethical issues	3.774	0.9424	1.0	5.0
C7	Management at all levels strictly prohibits circumvention of established policies and procedures, and demonstrates commitment to this principle	4.233	0.7476	1.0	5.0
C8	Internal auditors do audit soft controls as part of their	3.614	1.008	1.0	5.0

	Internal Control Implementation	Mean	SD	Min.	Max.
	planned audit program, and they have specified audit tools for that purpose				
C9	In the last 3 years, my bank has implemented inclusively and/or partially certain strategies in relation to one of the following soft control topics: focus on core values, errors handling policy, employee empowerment, self-directed work teams, transparency related issues	3.955	0.7964	2.0	5.0
C10	In my bank, any violation to the code of conduct is being reported through predefined channels e.g. hot-line	3.915	0.9765	1.0	5.0
C11	Performance appraisals adequately address the adherence to soft controls, and set forth criteria for integrity and ethical behavior	3.885	0.8999	1.0	5.0
C12	My bank's business ethics are for appearances only	2.083	1.254	1.0	5.0
C13	In the event of known soft control breaches or deficiencies, appropriate and timely actions are being taken on such breaches	3.774	0.9818	1.0	5.0
C14	In my knowledge, good employee suggestions are acknowledged by providing incentives or other meaningful recognition	3.609	0.9361	1.0	5.0
C15	Top management is receptive to comments by internal and external auditors regarding control deficiencies or suggestions for process improvement.	4.143	0.7086	2.0	5.0
C16	As a result of the positive attitude of management in the previous question, appropriate actions are being taken and documented	4.075	0.6470	3.0	5.0
C17	Evaluations of soft controls (environmental controls) are only performed when there are major strategy changes, new operations and/or processes have been adopted or changed	3.159	1.002	1.0	5.0
C18	In my department, management takes the appropriate disciplinary actions in response to departures from approved policies and procedures or violations of the code of conduct	3.92	0.806	2.0	5.0
C19	Deficiencies in soft controls are identified by on-going and separate monitoring activities of the bank	3.82	0.815	1.0	5.0
	Overall	**3.736**	**0.5452**	**2.2**	**4.8**

5.2.4. Limitations and Hindrances of Soft Controls

Table 10 below shows the means and standard deviations of all 12 questions within the category. From the analysis below it is clear that the overall mean is **2.257**, and there is no noted dispersion in the

standard deviation of category items. Chart no. 4 shows the linearity of the mean and standard deviation of all responses.

In addition all responses lay between disagreement 1 and full agreement 4.8.

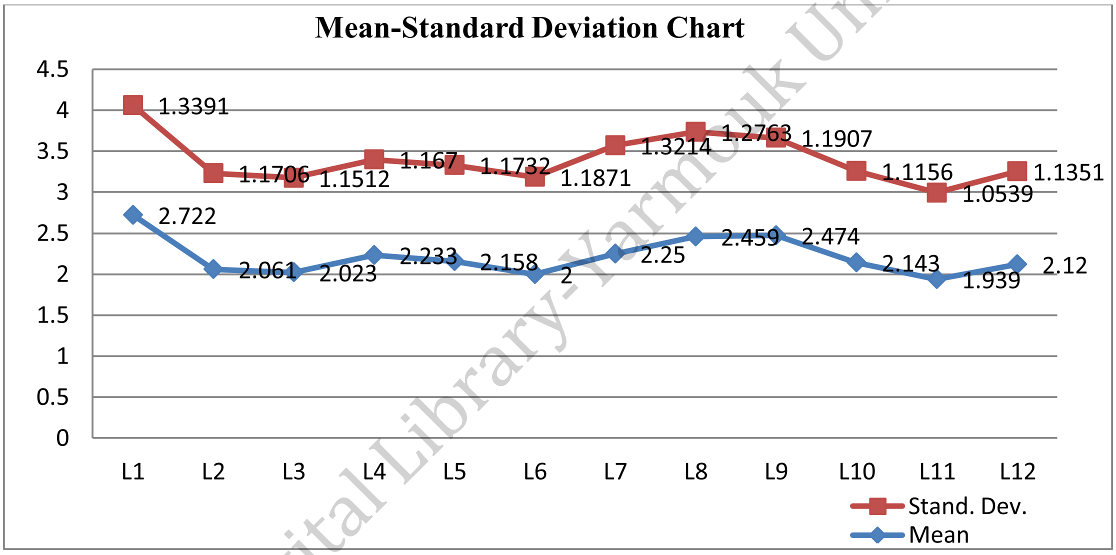


Chart 4

Table 5-10: Means and Standard Deviations of Limitations and Hindrances

	Limitations and hindrances level	Mean	SD	Min.	Max.
L1	Top management rarely addresses and resolves violations of behavioral and ethical standards consistently, timely, and equitably in accordance with the provisions of the Bank's Code of Conduct	2.722	1.3391	1.0	5.0
L2	In my knowledge, management in general lacks the requisite commitment to integrity and ethical behavior	2.061	1.1706	1.0	5.0
L3	I usually receive this message from my management, "Do your job and achieve your objective, I do not know how, just do it"	2.023	1.1512	1.0	5.0
L4	Employees face pressures to cut corners, consequently they could not generally be inclined to do the "right thing"	2.233	1.167	1.0	5.0
L5	Neither the existence of the code of conduct or its absence makes difference, in fact I cannot say that the code of conduct in my bank represents an effective	2.158	1.1732	1.0	5.0

	Limitations and hindrances level	Mean	SD	Min.	Max.
	deterrent to unethical behavior				
L6	My management does not have the specialized knowledge, experience, and training required to perform properly its duties at highest professional levels	2.0	1.1871	1.0	5.0
L7	There is a lack of adequate supervision from the audit/risk management committee (s) to all internal control and audit activities	2.25	1.3214	1.0	5.0
L8	Audit and/or risk management committee (s) rarely meets privately with the internal and external auditors and the risk people to discuss any aspect of weakness that might prevent the effective implementation of internal control system	2.459	1.2763	1.0	5.0
L9	In my knowledge, there is insufficient involvement to the board and audit committee in evaluating the effectiveness of the "tone at the top" and taking steps to ensure its appropriateness	2.474	1.1907	1.0	5.0
L10	I do not believe that my management considers what I do in terms of "adding value" to the bank's overall strategy	2.143	1.1156	2.0	5.0
L11	The communication channels in my bank are not clear and transparent enough to report suspected improprieties related to the bank's business ethics	1.939	1.0539	2.0	5.0
L12	I believe that persons who reports on such a suspected behaviors and/or improprieties are not protected enough against any reprisal actions	2.12	1.1351	1.0	5.0
	overall	**2.257**	**0.9153**	**1.0**	**4.8**

5.3. Testing Research Hypotheses

After descriptive statistics of mean and standard deviations have been conducted, one sample T-Test analysis also has been conducted regarding each set of the questionnaire main sections. In the following paragraphs T-tests will be illustrated. Once this accomplished some conclusions will be reached concerning the hold standing of hypotheses.

Testing H1 – There is a strong awareness level in soft controls among parties interested in internal controls.

It is worth noting that the group or scales A1 – A17 constitute the independent variable "awareness level" (see table 5-7, page 82), and some of

these scales have different perception and as a consequence their values should be reversed. In addition, more attention should be paid to such scales e.g. A3 is intended to measure the ability of the respondent to identify whether the scale represent a soft control, so if the scale is actually a hard control, the answer then could take value of 1 (strongly disagree) or 2 (disagree) or 3 (neutral) and if the scale is really a soft control then the scale will take the values of 5 (strongly agree) or 4 (agree) or 5 (neutral), based on that I approached this situation distinctly focusing on the scales from A3 to A6 in table H1-2. However, table 5-7 illustrates the descriptive statistics related to the scales under the independent variable "Awareness level"

Table 5-7 shows clearly that the mean of the intended scales is very supporting to the hypothesis H1, means of all scales range from 3.674 – 4.636. A15 is considered an exception from that as long respondents were asked to express their opinion regarding a negative statement "I think my bank's core beliefs are just words people use".

Part of the questionnaire was designed to distinguish between the persons who can identify soft controls among other control procedures. So four subordinate questions have been introduced to measure this awareness under the following question: To what extent do you consider the following to play a role as a soft control: Approvals/Authority Levels, Segregation of duties, Reconciliations, Performing control self assessment?

It is expected that the responses on the questions range from I strongly disagree to I disagree; on the contrary the responses did not satisfy the expectations. Table H1-1 we will see a descriptive statistical analysis of responses:

Table H1-1: Descriptive Statistical Analysis of Responses to Scales From A3-A6

Responses / Responses Distribution	Approvals/Authority Levels	percentage	Segregation of duties	percent	Reconciliations	percent	Performing control self assessment	percent
I strongly disagree	**1**	**0.8**	**1**	**.8**	**5**	**3.8**	**2**	**1.5**
I disagree	**6**	**4.5**	**4**	**3.0**	**8**	**6.1**	**4**	**3.0**
I'm neutral	**30**	**22.7**	**16**	**12.1**	**21**	**15.9**	**25**	**18.8**
I agree	50	37.1	48	36.4	58	43.2	53	39.8
I strongly agree	42	31.8	61	46.2	35	26.5	46	34.6

By performing the one sample T-Test analysis in table H1-2, it is clear that the significance is very supporting.

Table H1-2: Results of the one Sample T-Test Analysis

	Test Value = 3					
	T	Df	Sig. (2-tailed)	Mean difference	95% confidence interval of the difference	
					lower	upper
Average Awareness and Acting	23.510	132	.000	.9800	.898	1.062

Testing H2 – There is a sound and clear perception to the importance of soft controls in the financial sector in Jordan as essential ingredient in the internal control system, as noted from the means and standard deviation analysis (see table 5-8, page 84).

By performing the one sample T-Test analysis in table H2-1, it is clear that the significance is very supporting.

Table H2-1: Results of the One Sample T-Test Analysis

	Test Value = 3					
	T	Df	Sig. (2-tailed)	Mean difference	95% confidence interval of the difference	
					lower	upper
the weighted average scores of recognition of importance	20.417	132	.000	.9328	.842	1.023

Testing H3 – There is an effective implementation of soft controls in the Jordan financial institutions, as noted from the analysis of means and standard deviations (see table 5-9, page 86).
However scale no. CI12 where respondents were asked to express their opinion regarding the statement "My bank's business ethics are for appearances only" the agreement with this statement tends to be noted and contradict the recorded Soft control implementation level that tends to be above 3 as mentioned in the above paragraph, in addition to that 32.6% of respondents' responses came neutral or agree partially or totally with the statement. I perceive that the responses of respondents hide dissatisfaction from the way internal controls are applied. Table H3-1shows the exact distributions of responses after have been reversed:

Table H3-1: Distributions of Responses after Have Been Reversed

My bank's business ethics are for appearances only					
		Frequency	**Percent**	**Valid Percent**	**Cumulative Percent**
Valid	I Strongly Agree	62	46.6	47.0	47.0
	I Agree	27	20.3	20.5	67.4
	I'm Neutral	**19**	**14.3**	14.4	81.8
	I Disagree	**18**	**13.5**	13.6	95.5
	I Strongly Disagree	**6**	**4.5**	4.5	100.0
	Total	132	99.2	100.0	
Missing		1	.8		
Total		133	100.0		

By performing the one sample T-Test analysis in table 3-2, it is clear that the significance is very supporting.

Table H3-2: Results of the one Sample T-Test Analysis

	Test Value = 3					
	T	Df	Sig. (2-tailed)	Mean difference	95% confidence interval of the difference	
					lower	upper
Average Control Implementation	15.574	132	.000	.7362	.643	.830

Testing H4 – There are no seen limitations and/or problems facing the effective implementation of soft controls. This is noted from the analysis of means and standard deviations (see table 5-10, page).

It is worth to note that all responses are reversed because the questions are designed to give low values in the case the respondent is satisfied with the question. Except for the last question which requested the respondents their opinion about the need for improvements in the status of soft control in the respondent workplace, table H4-1 shows that the mean of responses are 2.744 which means that respondents generally see that the need for improvement overweight the extent of limitations in the work place, this can be seen from comparing the means of L1 to L12 that fall between 1.9 to 2.72 while the need for improvements has got a mean of 2.74. I think respondents expressed frank perception that soft controls need to be enhanced even though the level of limitations is lower that the perceived need for improvement.

However the distribution of responses in table H4-2 shows that 46.5% of responses are or neutral or agree on the need for improvements and 27.1% of them agree or strongly agree on this need for improvements:

Table H4-1: Mean of Responses on Measure L13

I believe there is lots to do in order to improve the status of soft control in my workplace	
Mean	2.744
Std. Deviation	1.1976
Minimum	1.0
Maximum	5.0

Table H4-2: Distribution of Agree or Neutral Responses on Measure L13

I believe there is lots to do in order to improve the status of soft control in my workplace					
Valid	I Strongly Disagree	20	15.0	15.0	15.0
	I Disagree	43	32.3	32.3	47.4
	I'm Neutral	**34**	**25.6**	25.6	72.9
	I Agree	**23**	**17.3**	17.3	90.2
	I Strongly Agree	**13**	**9.8**	9.8	100.0
		133	100.0	100.0	

By performing the one sample T-Test analysis in table H4-3, it is clear that the significance is very supporting.

Table H4-3: Results of the One Sample T-Test Analysis

	Test Value = 3					
	T	df	Sig. (2-tailed)	Mean difference	95% confidence interval of the difference	
					lower	upper
Average Limitations and Hindrances	-9.360	132	.000	-.7429	-.900	-.586

5.4. Conducting Further Analysis

Because of the nature of soft control topic, and the lack of research in Jordan and the developing countries on the topic of soft controls, it has felt the necessity of conducting further analysis on the variables included in the study. The following sections provide these analyses:

5.4.1. Studying Correlations:

5.4.1.1. The Simple Bivariate Correlation (between two variables), table 5-12 shows certain subordinate hypotheses derived from the original hypotheses this research is based on.

Table 5-12: Subordinate Hypotheses Derived From the Original Hypotheses

Subordinate Hypotheses	Independent Variable	Dependent Variable	R	S
1. The level of total perceived awareness of soft controls TAC has a strong effect on the steadiness level of a bank's reputation in the community A17	TAC	A17	0.681	0.01
2. The level of total perceived awareness TAC has a strong effect on the perceived improvement in the level of integrity of people in the workplace A16	TAC	A16	0.612	0.00
3. the importance of soft controls TRI has a strong effect on the level of appropriateness of implementing soft controls CI1	TRI	CI1	0.718	0.000
4. The perceived high commitment to competence and the demonstration of adequate knowledge and competence from both management and employees R7 has a strong effect on the level of appropriateness of implementing soft controls CI1	R7	CI1	0.600	0.000
5. the total perceived internal control limitations TLH has not a strong effect on The level of total perceived awareness TAC	TLH	TAC	-0.355	0.000
6. the total perception of limitations TLH has strong effect on the total perception that business ethics are for appearance only CI12	TLH	CI12	0.629	0.000
7. the perceived believe that top management thinks soft controls are real controls and heavily relies on them R4 has a strong effect on the perceived emphasizing of soft controls when it comes to directly investigate cases of fraud and occupational	R4	R3	0.279	0.01

Subordinate Hypotheses	Independent Variable	Dependent Variable	R	S
abuse R3				
8. the believe that soft control malfunctions have negative consequences on the implementation of hard controls R1has a strong effect on the perception that people in the workplace implement appropriately soft controls CI1	CI1	R1	0.339	0.000
9. the perceived total internal control limitations TLH has a strong effect on the perception that people in the workplace implement appropriately soft controls CI1	THL	CI1	-0.305	0.000
10. the perceived reliance of management on soft controls R4 has strong effect on the daily identification of deficiencies of soft controls done by management CI19	R4	CI19	0.441	0.000
11. The perceived management actions to prohibit the circumvention of policies and procedures CI7 has a strong effect on the appropriate implementation of soft controls CI1	CI7	CI1	0.613	0.000

5.4.1.2. Partial Correlations

Table 5-13 shows the results of the partial correlations between different subject matters expressed in the form of subordinate hypotheses:

Table 5-13: Results of Partial Correlation

S	Partial Correlation	R with no C.	Significance	R with C.	Significance	Interpretation
1	The total perception of limitations on the total perception that business ethics are for appearance only controlling for the implementation of positive internal control enhancers TPPE.	0.629	0.000	0.566	0.000	The controlling variable has a very small effect equal to 0.629-0.566=0.063 or 10% of the original R.
2	The total perception of limitations and hindrances has strong effect on the total perception that business ethics are for appearance only controlling for the implementation of negative internal control enhancers TPNE.	0.629	0.000	0.573	0.000	The controlling variable has very small effect equal to 0.629-0.573=0.056 or 0.89% of the original R
3	The perceived effect of reliance of management on soft controls R4 on the daily identification of deficiencies of soft	0.441	0.000	0.080	0.362	The controlling variable has huge effect equal to 81.8%,

S	Partial Correlation	R with no C.	Significance	R with C.	Significance	Interpretation
	controls done by management CI19 controlling for the implementation of negative internal control enhancers TPNE.					with low significance 0.362 that refers to the probability that our estimates are correct
4	The perceived effect of reliance of management on soft controls R4 on the daily identification of deficiencies of soft controls done by management CI19 controlling for the implementation of positive internal control enhancers TPPE.	0.441	0.000	0.103	0.242	The controlling variable has huge effect equal to 76.6%, with low significance 0.242 that refers to the probability that our estimates are correct
5	The perceived effect of total recognition of soft controls TRI has strong effect on the perceived application of soft controls as intended supported with proper identification of risks CI5, controlling for the implementation of positive internal control enhancers TPPE	0.627	0.000	0.190	0.033	The controlling variable has a huge effect equivalent to 0.627-.190 = 0.437 or 69.6% of the original correlation coefficient
6	The perceived effect of total recognition of soft controls TRI on the perceived application of soft controls as intended supported with proper identification of risks CI5 controlling for the implementation of the negative enhancers TPNE	0.627	0.000	0.210	0.018	The controlling variable has a huge effect equivalent to 0.627-.210 = 0.417 or 66.5% of the original correlation coefficient
7	the perceived effect of total internal control limitations TLH on the need for improvements to the status of soft control, controlling for the insufficient involvement of the board and audit committee in evaluating the effectiveness of the “tone at the top” and taking steps to ensure its appropriateness L9	0.547	0.000	0.254	0.004	The controlling variable has a huge effect equivalent to 0.547-.254 = 0.293 or 53.5% of the original correlation coefficient

5.4.2. Multiple Regressions

Table 5-14 shows some applications to the regressions model on certain topics, noting that there is no violation of the assumptions of Multicollinearity, sample size, Normality, Linearity, Homoscedasticity, and the Independence of Residuals:

Table 5-14: Application of Regressions

Regression	R square	Adjusted R Square	ANOVA significance	independent variable makes the strongest unique contribution to explaining the dependent variable	Significance of beta	Number of sds scores in the dependent variable would change if there was a one standard deviation unit change in the ...	Part Correlation
1. How well do the perceived negative internal control enhancers (related to implement strict policies including retribution measures) affect the application of soft controls the way they are intended to be and are related to the identified risks	50.11%	48.2%	0.000	0.302	0.000	0.231	5%
2. How well do the total measures of positive internal control enhancers affect the application of soft controls the way they are intended to be and are related to identified risks	38.9%	36.4%	0.000	0.273	0.005	0.222	4%
3. How well do the total measures of communication status in banks affect the perception that soft controls are an integral part of the dominate culture in banks	52%	48.8%	0.000	0.248	0.003	0.211	3.7 %
4. How well do the total measures of perceived example role of management toward soft controls affect the appropriate implementation of soft controls at departmental level	56.2%	53.4%	0.000	0.274	0.005	0.2052	2.9 %
5. How well do the total measures of perceived monitoring status in banks	46%	43.3%	0.000	0.278	0.002	0.208	4.4 %

Regression	R square	Adjusted R Square	ANOVA significance	independent variable makes the strongest unique contribution to explaining the dependent variable	Significance of beta	Number of sds scores in the dependent variable would change if there was a one standard deviation unit change in the	Part Correlation
affect the appropriate implementation of soft controls							

5.4.3. Independent-Samples T-Test

Tables T-Test1 and T-test 2 shows various levels of comparisons between groups and the distribution of responses that are supposed to add value to the conclusions of this research, while table 5:

Table T-Test1: Comparisons between Groups

Comparison	Equality of Variance, above 0.05 Levene's test	Significance of difference, above 0.05	magnitude of the differences between groups because of the sample size (eta)
1. Comparison between the group of respondents who holds professional certificates PC, and who do not in terms of level of awareness	0.409	0.325	0.0083 – small
2. Comparison between the group of respondents who holds professional certificates and who do not, in terms of perceived control implementation	0.236	0.301	.00936 – small
3. Comparison between the group of respondents who have moderate years of experience and who have long years of experience in terms of level of awareness	0.671	0.780	0.0006 – small
4. Comparison between the group of respondents who	0.05	0.501	0.00219

Comparison	Equality of Variance, above 0.05 Levene's test	Significance of difference, above 0.05	magnitude of the differences between groups because of the sample size (eta)
have moderate years of experience and who have long years of experience in terms of perceived control implementation			– small
5. Comparison between the group of respondents who appreciate the role of soft control and persons who do not in terms of perceived control implementation	0.65	0.901	0.00707 Small
6. Comparison between the group of respondents who hold an executive position and who do not in terms of level of awareness	0.114	0.833	0.0072 Small
7. Comparison between the group of respondents who hold an executive position and who do not in terms of perceived control implementation	0.986	0.813	0.0069 Small
8. Comparison between the group of respondents who hold an executive position and who do not in terms of perceived internal control limitations	0.075	0.388	0.0015 Small

Table T-test 2: Distribution of Responses

Number and subject of the Independent T-Test	Type of group	No. of respondents	Mean	Standard deviation
Level of awareness	Holding pC	57	71.175	9.2526
	Non-holding	61	72.787	8.4717
Perceived soft control implementation	Holding PC	56	69.357	10.9435
	Non-holding	60	71.300	9.1842
Level of awareness	Moderate years of experience	66	72.212	9.5346
	Long years of experience	52	71.750	7.9972
Perceived soft control implementation	Moderate years of experience	63	70.952	9.1112
	Long years of experience	53	69.660	11.1613

Number and subject of the Independent T-Test	Type of group	No. of respondents	Mean	Standard deviation
Perceived soft control implementation	Appreciate the internal control role	76	70.447	10.2507
	Do not appreciate the internal control role	40	70.200	9.8585
Level of awareness	Holding executive position	20	72.200	7.5016
	Non-holding executive position	68	71.691	9.9465
Perceived soft control implementation	Holding executive position	19	69.842	11.1219
	Non-holding executive position	69	70.493	10.4426
Perceived soft control limitations	Holding executive position	22	28.955	13.5136
	Non-holding executive position	75	26.533	10.8657

Chapter six

Conclusions, Recommendations, and Implications

Table of Contents

The purpose of this chapter is to present the main findings of the study and then presenting the recommendations necessary in order to put into effect any needed measure to make the soft control playing the supposed role in the effective implementation of internal control systems

6.1. Conclusions and Recommendations

1. Adequate training is highly requested to boost senior management and employees' knowledge status. Central Bank of Jordan as it plays the mentor role has to play an essential role in this regard.

2. Where respondents were asked to express their opinion regarding the statement "My bank's business ethics are for appearances only" the agreement with this statement tends to be noted, this means that soft control in the work place need to be enhanced because of the negative perception that soft controls are in place and effectively working. This contradicts the recorded Soft control implementation level as long 32.6% of responses came neutral or agree partially or totally with the statement. I perceive that the responses of respondents hide dissatisfaction from the way internal controls are applied (table H3-1 shows the exact distribution of responses).

3. When respondents were asked to express their opinion about the need for improvements in the status of soft control in the workplace, responses came with a mean equal to 2.744. this means that respondents generally see that the need for improvement overweight the extent of limitations in the work place, this can be seen from comparing the means of L1 to L12 that fall between 1.9 to 2.72 while the need for improvements has got a mean of 2.74. I think respondents expressed frank perception that soft controls need to be enhanced even though the level of limitations is lower that the perceived need for improvement. However the distribution of responses in table H4-2 shows that 46.5% of responses are or neutral or agree on the need for improvements and 27.1% of them agree or strongly agree on this need for improvements.

4. Even though the mean of total perceived limitations is moderately low (2.257), we can clearly see that the perceived limitations have a high correlation coefficient (0.629) with the perception that people's feeling

that business ethics are for appearance only. It seems that there is a controlling factor that dominates this relationship.

After conducting further analysis using controlling variables (the positive and negative internal control enhancers), we have got almost the same result, there is a high correlation despite the fact that limitations have been judged to be at low level. It seems that some other personal factors like the lack of trust in management actions are affecting this perception. My recommendation here is to conduct further researches in order to explore the root causes behind this unexplained relationship.

5. Nevertheless that the presumed correlation between the perceived believe that top management thinks soft controls are real controls and heavily relies on them has a strong effect on the perceived emphasizing of soft controls when it comes to directly investigate cases of fraud and occupational abuse. It has been found that there is a small correlation. This implies that there is a controlling variable that might altered the normal relationship. It seems that the rule "make you words walk" is not applied, in addition to practicing internal politics in handling fraud and occupational abuse issues.

6. The same conclusion could be applied on "the respondents' believe that soft control malfunctions have negative consequences on the implementation of hard controls has a strong effect on the perception that people in the workplace implement appropriately soft controls". The relationship is supposed to be strong, but on the contrary the correlation analysis gives a moderately low R between the variables 0.339. It can be concluded that the problem is more related to the implementation of other soft controls like leadership values, the just treatment of emerging business and personal issues. Conducting further research on the proper implementation of detailed soft controls is highly recommended here.
7. It is noted that the perceived reliance of management on soft controls has strong effect on the daily identification of deficiencies of soft controls done by management, although the correlation is positive but it is considerably weak correlation, it seems that there is some controlling factors affecting the daily basis. After another correlation test has been applied using the negative enhancers as a controlling variable it has been found that 81% of the relationship is because of the controlling variable. It seems that disciplinary actions have greater effect on people than the good welling of management.

8. It is noted that no differences are found between various groups of respondents e.g. who hold professional certificate and who do not. With respect to the level of awareness, the effective implementation of soft controls and the perceived internal control limitations among such groups, except for the groups of respondents with respect to the perceived effectiveness of soft control implementation between respondents who have long experience and moderate experience, where the variance between the two groups is significant.

   It seems that there are strict policies governing the way people are being aware or implementing soft controls, and there is a dominant culture in banks guiding the way people perceiving the above mentioned issues. More incentives should be directed toward enabling those certified in internal control, risk management, and any other internal control related field to exercise their acquired knowledge to boost the soft control status. In addition, more participative and interactive methods should be implemented to increase the level of corporate learning.

6.2. Implications of the Study

The study of soft controls leads to how much important is the identification of all interrelated soft risks; such soft risks should be considered part of the risk analysis in the banking institutions and in all cross-wide firms despite its industry field as well. This risk analysis should be conducted as part of our understanding that risks affect firms ability to achieve its predefined objectives at strategic and operational levels. In addition, risk practitioners should identify also what is needed of internal controls, especially those hard ones to manage the soft risks e.g. in controlling the risk of inappropriate style of leadership; management might use the 360 degree performance appraisal as a hard control to measure how much management is discharging its responsibility toward achieving the firm goals.

Examples of soft risks might be:

- Implementation of an inappropriate style of leadership.
- Inadequate communication within the firm.
- Insufficient management of expectations with the environment.
- Inadequate involvement of management.

As well risk management function should sponsor the analysis and management of soft risks; internal auditors should in their turn encompass

such risks in their risk based audit plan, and as a result, this implies raising the understanding level of auditors in soft risks and soft controls in order to fulfill this new responsibility.
Internal auditors need to take into account the more 'softer' aspects of an audit like:

- Direct observation instead of ticking the documentations.
- Usage of skills level criteria to stand on how much management is skilful.
- The communication channels and cross-functional across the entity.
- The involvement and support practiced by management.
- Whether the culture of the entity stimulates creativity.

In order to handle the softer aspects auditors might use the following audit technique:
- Interviews.
- Surveys.
- Observations on site.

This could be called the audit behavioral model, which has the capacity to strengthen knowledge about how people impact an organizations internal control system and risk profile.

To conclude, more scrutinized work should be exerted here from professional forums and training institution to shed light on this important side of soft controls and soft risk.

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Appendixes

Table of Contents

Appendix 1

Past Operational Loss Events (Fraud Cases)

Entity	Loss amount $	Date	description
Bank of credit and commerce	17,000,000,000	1991	Regulators seized about 75 percent of the bank of credit and commerce international's $17 billion in assets in a major fraud
Long term capital management	4,000,000,000	1998	Huge market losses due to model risk and inadequate controls. The excesses include overexposure to leverage, sovereign model, liquidity, volatility risk, and the failure to implement a balanced risk management strategy
Tokyo Shinkin bank	2,300,000,000	1990-1991	The manager of the imasato branch forged 19 deposit certificates with the face value of 416 billion yen. The deposit slips were used to raise money for stock deals worth 172.5 billion yen in stocks and debentures.
Banca Nazionale del Lavoro	1,800,000,000	1992	Former employees pleaded guilty to conspiring to arrange from $5 billion in unauthorized loans to Iraq.
Barings bank	1,000,000,000	1995	The loss was larger than the bank's entire capital base and reserves, an employee Nick leeson, was able to hide the losses in a special account that he controlled. He violated the core OP risk practices e.g. dual control and check of balances.
Socie'te' Ge'ne'rale[6]	6,400,000,000	2008	Jérôme Kerviel a trader in the bank had been trading profitably in anticipation of falling market prices; however, they have accused him of exceeding his authority to engage in unauthorized trades. Bank officials claim that Kerviel tried to conceal the activity by creating losing trades intentionally so as to offset his early gains.
JPMorgan Chase[7]	2,000,000,000 This is the admitted figure	2012	Ignoring internal controls and manipulating documents, while the chief executive withheld some information from the regulators.

[6] http://www.guardian.co.uk/business/2010/nov/21/societe-generale-jerome-kerviel-sentence-comment

[7] http://dealbook.nytimes.com/2013/03/14/jpmorgan-faulted-on-controls-and-disclosure-in-trading-loss/

Appendix 2

Detailed Loss Event Type Classification

Event-Type Category (Level 1)	Definition	Categories (Level 2)	Activity Examples (Level 3)
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/ discrimination events, which involves at least one internal party	Unauthorised Activity	Transactions not reported (intentional) Transaction type unauthorised (w/monetary loss) Mismarking of position (intentional)
		Theft and Fraud	Fraud / credit fraud / worthless deposits Theft / extortion / embezzlement / robbery Misappropriation of assets Malicious destruction of assets Forgery Check kiting Smuggling Account take-over / impersonation / etc. Tax non-compliance / evasion (wilful) Bribes / kickbacks Insider trading (not on firm's account)
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party	Theft and Fraud	Theft/Robbery Forgery Check kiting
		Systems Security	Hacking damage Theft of information (w/monetary loss)
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity / discrimination events	Employee Relations	Compensation, benefit, termination issues Organised labour activity
		Safe Environment	General liability (slip and fall, etc.) Employee health & safety rules events Workers compensation
		Diversity & Discrimination	All discrimination types
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.	Suitability, Disclosure & Fiduciary	Fiduciary breaches / guideline violations Suitability / disclosure issues (KYC, etc.) Retail customer disclosure violations Breach of privacy Aggressive sales Account churning Misuse of confidential information Lender liability

Event-Type Category (Level 1)	Definition	Categories (Level 2)	Activity Examples (Level 3)
		Improper Business or Market Practices	Antitrust Improper trade / market practices Market manipulation Insider trading (on firm's account) Unlicensed activity Money laundering
		Product Flaws	Product defects (unauthorised, etc.) Model errors
		Selection, Sponsorship & Exposure	Failure to investigate client per guidelines Exceeding client exposure limits
		Advisory Activities	Disputes over performance of advisory activities
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events.	Disasters and other events	Natural disaster losses Human losses from external sources (terrorism, vandalism)
Business disruption and system failures	Losses arising from disruption of business or system failures	Systems	Hardware Software Telecommunications Utility outage / disruptions
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors	Transaction Capture, Execution & Maintenance	Miscommunication Data entry, maintenance or loading error Missed deadline or responsibility Model / system misoperation Accounting error / entity attribution error Other task misperformance Delivery failure Collateral management failure Reference Data Maintenance
		Monitoring and Reporting	Failed mandatory reporting obligation Inaccurate external report (loss incurred)
		Customer Intake and Documentation	Client permissions / disclaimers missing Legal documents missing / incomplete
		Customer / Client Account Management	Unapproved access given to accounts Incorrect client records (loss incurred) Negligent loss or damage of client assets
		Trade Counterparties	Non-client counterparty misperformance Misc. non-client counterparty disputes
		Vendors & Suppliers	Outsourcing Vendor disputes

Appendix 3

<table>
<tr><th colspan="2">Control Maturity Model</th></tr>
<tr><td colspan="2">Soft Control Element: Integrity and Ethical Values: Sound integrity and ethical values, particularly of senior management, are developed and set the standard of conduct for doing business.</td></tr>
<tr><th>Control Maturity Level</th><th>Control Attribute</th></tr>
<tr><td>Senior management develops a clearly articulated statement of values or ethical behaviors that are understood by key executives and the board.</td><td>• Senior management conveys the message that integrity and ethical values cannot be compromised, both in words and in actions.
• Senior management has developed a code of ethics that emphasizes the organization's expectation that employees will act with integrity in all actions related to their scope of employment.
• Senior management has developed a code of business conduct that emphasizes the organization's commitment to fair and honest dealings with customers, suppliers, and other external parties.
• Performance expectations and incentives are designed so as to not create undue temptations to violate laws, rules, regulations, and organization policies and procedures.</td></tr>
<tr><td>Senior management communicates its commitment to ethical values through words and actions.</td><td>• New employees receive a copy of the organization's code of ethics and code of business conduct and are trained as to how these guidelines apply to specific factual situations common to the organization's business environment.
• Existing employees are provided with updated copies of the organization's code of ethics and code of business conduct at least yearly, and receive periodic retraining on the application of these guidelines to the organization's business environment.
• Customers, vendors, and other external parties receive a copy of the organization's code of business conduct at least yearly, by inclusion in other mailings to these parties. Contractual arrangements with these parties should include requirements for adherence to the organization's code of ethics and code of business conduct.</td></tr>
<tr><td>The importance of integrity and ethical values is communicated and reinforced to all employees in a manner suitable for the organization.</td><td>The organization's newsletter (and other internal communication devices) highlights:
a. Ethical dilemmas often arising in the organization's industry and how management expects employees to act in these situations.
b. Ethical failures (with names disguised) and the consequences of these failures for both the organization and the employees involved.
c. Ethical successes (with names retained and highlighted) with the situation described, the employee behavior, and why the behavior was consistent with organization guidelines.</td></tr>
<tr><td>Processes are in place to monitor the organization's compliance with principles</td><td>• All new employees are required to sign the code of ethics and business conduct indicating that they have read and understand these codes.</td></tr>
</table>

Control Maturity Model	
of sound integrity and ethical values.	• All existing employees are required to sign an annual contract acknowledging that they have read the most recent versions of the code of ethics and business conduct and that they understand and are in compliance with these codes. • HR or hiring department management monitor whether new and existing employees have completed the required training on the codes of ethics and business conduct. • The organization has established a hotline – a reporting mechanism that permits anonymity, and preferably staffed by an internal group with a direct reporting relationship to the board or by an outside vendor – for receiving reports of suspected violations of the organization's codes of ethics and business conduct and publicizes the existence of the hotline.
Deviations from sound integrity and ethical values are identified timely and are addressed and remediated at appropriate levels within the organization.	• A senior executive, preferably with a direct reporting relationship to the board, is responsible for oversight of the organization's ethics and compliance function. • Allegations of violations of the organization's codes of ethics and business conduct are appropriately investigated, and the necessary corrective, disciplinary, and remedial actions happen timely. This includes hotline reported matters.
Soft Control Element: Management's Philosophy and Operating Style: Management's philosophy and operating style support achieving effective internal control.	
Management's philosophy and operating style emphasize high-quality and transparent internal and external reporting, and the importance of effective internal control and risk management.	Management emphasizes the importance of meeting internal control objectives through both its words and actions.
Management establishes and clearly articulates internal control objectives.	• Internal control objectives over financial reporting, compliance with applicable laws and regulations, efficiency and effectiveness of operations, and safeguarding of assets are communicated to relevant individuals throughout the organization.
Management follows a disciplined, objective process in developing internal control objectives.	• The organization follows a periodic, disciplined process for establishing internal control objectives over financial reporting, compliance with applicable laws and regulations, efficiency and effectiveness of operations, and safeguarding of assets and involves senior financial and operating management.
Soft Control Element: Commitment to Competence: The organization retains individuals competent in financial reporting, internal control, and risk management, and related oversight roles.	
Competencies that support effective financial reporting, internal control, and risk management are identified.	• A clear and transparent competency strategy/plan exists that is aligned to the organization's business strategy and objectives. The strategy has been approved by executive management and communicated. The strategy/plan should include the competency requirements for activities that have been

Control Maturity Model	
	outsourced. The plan should include methods for acquiring the competencies required. • Plans are in place to ensure the appropriate level of staffing. • Formal job/role descriptions exist that define tasks and competencies for each position. Job/role descriptions (and experience) should include both skills and behaviors necessary to complete the assigned work. For each competency, the desired level of competency should be articulated.
The organization employs or otherwise utilizes individuals who possess the required competencies in financial reporting, internal control, compliance, and risk management.	• Individuals are placed in positions based on the fit of their competencies (and experience) to the job requirements as defined by the job descriptions. • In filling key management positions, broad functional experience should be a goal. • Consideration is given to competency of service providers when outsourcing activities. • There should be a plan to cross train management and staff to provide understanding of other functions impacting their specific duties and for back-up. • Plans are in place to ensure adequate staffing levels are maintained. Succession plans for key positions exist and individuals identified in those succession plans have the required competencies or plans exist to develop those competencies. • There is a process in place to obtain assistance for highly complex technical matters. • Hiring of individuals includes background checks and references, etc.
Needed competencies are regularly evaluated and maintained.	• There is a competency assessment approach and guidance that is documented and updated regularly. The approach is designed to identify competency gaps and establish written development plans to address gaps within a reasonable timeframe and a monitoring/reporting system to ensure that the gaps are addressed. • For individuals in key financial reporting, risk, and control functions, the board annually assesses their competencies. • Annual assessments of competencies and performance of both organization and outsourced service provider employees is in place. • Skills noted in job descriptions are part of the regular annual employee performance review.

Appendix 4

The Questionnaire Validation Sources

Validation source	The Name of Reviewer
Internally	• Professor Mishiel Suwaidan, the head of accounting division at Yarmouk University – faculty of economics and administration sciences.
	• Professor Fuad Al-Sheik, member of the teaching body at Yarmouk University – faculty of economics and administration sciences and the teacher of the scientific research methodologies.
Externally	• Dr. Michael Pregmon , The COO and managing director at the internal control institute in USA.
	• 3 persons of the group of respondents on the questionnaire.

Appendix 5

(Codebook)

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
Identification Number	**ID**		Number Assigned to Each Question	
Academic Background	AB	Nominal	1 = Less than bachelor's degree 2 = Bachelor's degree 3 = Master degree 4 = PHD	
Specialization Field	SF	Nominal	1 = Accounting 2 = Business Administration 3 = Finance 4 = Banking 5 = Others	
Professional Background	PC	Nominal	0 = None 1 = CPA 2 = CIA 3 = Risk Management Certificate 4 = CFE 5 = CICS 6 = Others 7 = More than one certificate	
Bank nationality	BN	Nominal	1 = Domestic 2 = Foreign	
Total years of experience	TYOE	Ratio	1 = < 5 2 = 5 – 10 3 = 11 – 15 4 = 16 – 20 5 = > 20	
Years of experience in the current position	YOECP	Ratio	1 = < 5 2 = 5 – 10 3 = 11 – 15 4 = 16 – 20 5 = > 20	
Nature of work	NOW	Nominal	1 = Board member 2 = Executive manager 3 = Internal control specialist 4 = Risk management specialist 5 = Internal auditor 6 = Others	

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
Of hybrid experience	HE	Nominal	0 = None 1 = In more than one bank 2 = Mix of domestic and foreign banks	
I'm treating corporate governance matters?	TCGM	Nominal	1 = Yes 2 = No	
I'm a member of internal control related committee (s), Specify:	MOICC	Nominal	1 = Yes 2 = No	
Ex- internal auditor	EXIA	Nominal	1 = Yes 2 = No	
I'm a member of an audit / risk management committee?	MOARC	Nominal	1 = Yes 2 = No	
I never participated in any committee whatever its role	NPIC	Nominal	1 = Yes 2 = No	Scores have been reversed
I appreciate the internal control role	AICR	Nominal	1 = Yes 2 = No	
Extent of considering People's integrity and ethical values to play a role as a soft control	A1	Interval	1 = Strongly Disagree 2 = Disagree 3 = Neutral 4 = Agree 5 = Strongly Agree	
Extent of considering Management's philosophy and operating style as a soft control	A2	Interval	Ranges from 1, strongly to 5, strongly disagree	
Extent of Considering Approvals/Authority Levels as a soft control	A3	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Extent of Considering Segregation of duties as a soft control	A4	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Extent of Considering Reconciliations as a soft control	A5	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Extent of Considering Performing control self assessment as a soft control	A6	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Extent of Considering Responsibility and accountability as a soft control	A7	Interval	Ranges from 1, strongly to 5, strongly disagree	
Extent of Considering Commitment to competence as a soft control	A8	Interval	Ranges from 1, strongly to 5, strongly disagree	
Information on soft controls is communicated effectively and clearly both up and down within my department and across other areas	A9	Interval	Ranges from 1, strongly to 5, strongly disagree	
My company's code of conduct and other policies regarding acceptable business practice, conflicts of interest, and expected ethical standards of ethical and moral behavior are comprehensive and relevant and address matters of significance to me	A10	Interval	Ranges from 1, strongly to 5, strongly disagree	

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
Employees in my department fully and clearly understand what behavior is acceptable and unacceptable under the bank's Code of Conduct and know what to do when they encounter improper behavior	A11	Interval	Ranges from 1, strongly to 5, strongly disagree	
Soft controls are an integral part of the dominate culture in my bank	A12	Interval	Ranges from 1, strongly to 5, strongly disagree	
Outside parties understand my bank's ethical and behavioral standards and the ethical behavior basis on which my bank expects those parties to execute their deals with it	A13	Interval	Ranges from 1, strongly to 5, strongly disagree	
In my bank, internal auditors and risk people assess employees' understanding and compliance with soft controls by holding interviews with them, by observation, or through questionnaires or any other relevant methods	A14	Interval	Ranges from 1, strongly to 5, strongly disagree	
I think my bank's core beliefs are just words people use	A15	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
The level of integrity of people in my department is getting better overtime	A16	Interval	Ranges from 1, strongly to 5, strongly disagree	
My organization's reputation in my community is remaining steady	A17	Interval	Ranges from 1, strongly to 5, strongly disagree	
I believe that any failure in the functionality of "soft" controls are the root causes of the subsequent failure in "hard" controls	R1	Interval	Ranges from 1, strongly to 5, strongly disagree	
Top management frequently communicates the importance of soft controls such as integrity and ethical behavior by all possible means	R2	Interval	Ranges from 1, strongly to 5, strongly disagree	
My bank emphasizes soft controls when it comes to directly investigate cases of fraud and occupational abuse	R3	Interval	Ranges from 1, strongly to 5, strongly disagree	
Top management thinks soft controls are real controls, and it heavily relies on them	R4	Interval	Ranges from 1, strongly to 5, strongly disagree	
Employees in my department understand what behavior is acceptable and what behavior is considered unacceptable	R5	Interval	Ranges from 1, strongly to 5, strongly disagree	
Employees in my department know what to do when they encounter improper behavior given the importance of ethical behavior	R6	Interval	Ranges from 1, strongly to 5, strongly disagree	
In my opinion, managers and employees in my bank show high level of commitment to competence, and they demonstrate that by having the adequate knowledge, competence, experience and training	R7	Interval	Ranges from 1, strongly to 5, strongly disagree	

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
necessary to fulfill their assigned responsibilities				
As the attitude of management toward risk is part of soft controls aspects and it sums up its operational philosophy. Managers in my bank move carefully, proceeding only after analyzing the risks and potential benefits of ventures	R8	Interval	Ranges from 1, strongly to 5, strongly disagree	
Top management's commitment to integrity and ethical behavior in its day-to-day activities is essential for the effective implementation of internal control system across the bank	R9	Interval	Ranges from 1, strongly to 5, strongly disagree	
The existence of the bank's Code of Conduct and the consequences of its breach are an effective deterrent to unethical behavior	R10	Interval	Ranges from 1, strongly to 5, strongly disagree	
In my department, people usually implement appropriately soft controls	CI1	Interval	Ranges from 1, strongly to 5, strongly disagree	
If your answer to the previous question was "I strongly agree" or "I agree", please answer the following question: Does implementation of soft controls started after the request of senior management and/or the board of directors?	CI2	Interval	Ranges from 1, strongly to 5, strongly disagree	
Managers at all levels do not ignore any sign of inappropriate behavior, on the contrary, they take it seriously	CI3	Interval	Ranges from 1, strongly to 5, strongly disagree	
My bank adopts and promotes a culture of integrity, including ethics, business practices and human resources evaluations	CI4	Interval	Ranges from 1, strongly to 5, strongly disagree	
Soft control procedures described in policy and procedure manuals are actually applied the way they are intended to be applied and relate clearly to identified risks	CI5	Interval	Ranges from 1, strongly to 5, strongly disagree	
Mechanisms exist to effectively collect and investigate information related to soft controls like business ethical issues	CI6	Interval	Ranges from 1, strongly to 5, strongly disagree	
Management at all levels strictly prohibits circumvention of established policies and procedures, and demonstrates commitment to this principle	CI7	Interval	Ranges from 1, strongly to 5, strongly disagree	
Internal auditors do audit soft controls as part of their planned audit program, and they have specified audit tools for that purpose	CI8	Interval	Ranges from 1, strongly to 5, strongly disagree	
In the last 3 years, my bank has	CI9	Interval	Ranges from 1, strongly to	

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
implemented inclusively and/or partially certain strategies in relation to one of the following soft control topics: focus on core values, errors handling policy, employee empowerment, self-directed work teams, transparency related issues			5, strongly disagree	
In my bank, any violation to the code of conduct is being reported through predefined channels e.g. hot-line	CI10	Interval	Ranges from 1, strongly to 5, strongly disagree	
Performance appraisals adequately address the adherence to soft controls, and set forth criteria for integrity and ethical behavior	CI11	Interval	Ranges from 1, strongly to 5, strongly disagree	
My bank's business ethics are for appearances only	CI12	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
In the event of known soft control breaches or deficiencies, appropriate and timely actions are being taken on such breaches	CI13	Interval	Ranges from 1, strongly to 5, strongly disagree	
In my knowledge, good employee suggestions are acknowledged by providing incentives or other meaningful recognition	CI14	Interval	Ranges from 1, strongly to 5, strongly disagree	
Top management is receptive to comments by internal and external auditors regarding control deficiencies or suggestions for process improvement.	CI15	Interval	Ranges from 1, strongly to 5, strongly disagree	
As a result of the positive attitude of management in the previous question, appropriate actions are being taken and documented	CI16	Interval	Ranges from 1, strongly to 5, strongly disagree	
Evaluations of soft controls (environmental controls) are only performed when there are major strategy changes, new operations and/or processes have been adopted or changed	CI17	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
In my department, management takes the appropriate disciplinary actions in response to departures from approved policies and procedures or violations of the code of conduct	CI18	Interval	Ranges from 1, strongly to 5, strongly disagree	
Deficiencies in soft controls are identified by on-going and separate monitoring activities of the bank	CI19	Interval	Ranges from 1, strongly to 5, strongly disagree	
Top management rarely addresses and resolves violations of behavioral and ethical standards consistently, timely, and equitably in accordance with the provisions of the Bank's Code of Conduct	L1	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
In my knowledge, management in general	L2	Interval	Ranges from 1, strongly to	Scores have

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
lacks the requisite commitment to integrity and ethical behavior			5, strongly disagree	been reversed
I usually receive this message from my management, "Do your job and achieve your objective, I do not know how, just do it"	L3	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Employees face pressures to cut corners, consequently they could not generally be inclined to do the "right thing"	L4	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Neither the existence of the code of conduct or its absence makes difference, in fact I cannot say that the code of conduct in my bank represents an effective deterrent to unethical behavior	L5	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
My management does not have the specialized knowledge, experience, and training required to perform properly its duties at highest professional levels	L6	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
There is a lack of adequate supervision from the audit/risk management committee (s) to all internal control and audit activities	L7	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Audit and/or risk management committee (s) rarely meets privately with the internal and external auditors and the risk people to discuss any aspect of weakness that might prevent the effective implementation of internal control system	L8	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
In my knowledge, there is insufficient involvement to the board and audit committee in evaluating the effectiveness of the "tone at the top" and taking steps to ensure its appropriateness	L9	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
I do not believe that my management considers what I do in terms of "adding value" to the bank's overall strategy	L10	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
The communication channels in my bank are not clear and transparent enough to report suspected improprieties related to the bank's business ethics	L11	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
I believe that persons who reports on such a suspected behaviors and/or improprieties are not protected enough against any reprisal actions	L12	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
I believe there is lots to do in order to improve the status of soft control in my workplace	L13	Interval	Ranges from 1, strongly to 5, strongly disagree	Scores have been reversed
Total perceived awareness	TAC			

Variable Name	SPSS Variable Name	Type	Coding Instructions	N.B
Total perceived recognition of importance	TRI			
Total perceived control implementation	TCI			
Total perceived limitations and hindrances	TLH			
Grouping professional certificates	GPC		0 = holding professional certificate 1 = non-holding professional certificate	
Total Perceived Positive Enhancers R2, R4, CI4, CI9, CI11, CI14, CI15	TPPE			
Total Perceived Negative Enhancers R10, CI3, CI6, CI7, CI8, CI10, CI11, CI13, CI18, CI19	TPNE			
Banded Total Years of Experience	BTYOE		1 = moderate experience 2 = Long experience	

Appendix 6

The Questionnaire

Dear Mme/Sir,

Good day,

I am sure that I'm putting a pressure on you by ask taking some of your valuable time to complete this questionnaire. However once you commence that you'll find that you are adding value to an important topic related to the successful implementation of internal controls system in your area.

This questionnaire comes as part of the completion requirements of obtaining the master degree in accounting at Yarmouk University. And it is intended to measure the level of awareness of soft controls (the intangible controls that management emphasizes to direct the organization's expectations and behavior), the perception of its importance, the effectiveness of implementation, and finally its limitations of their implementation across the Jordan financial system. In the following two paragraphs it will be introduced to your kind concern the importance of considering the soft controls and the nature of soft controls.

The investment in formal internal control does not seem effective enough in today's financial climate. Hence the feeling that the formal control firewall is powerless against the violations of internal control procedures that everyone has been able to witness. At this stage soft controls come into effect and now a day are considered the intangible driver of the successful implementation of internal controls systems.

"Soft Controls" are meant to be related to the culture of the organization and the people performing the work to meet the objectives of such an organization. Soft controls are referred by other scholars as informal, subjective, intangible, and the real terrain of the organization. Examples of soft controls are:

Tone at the top	Ethical climate	Trust
Morale	Operational philosophy	Corporate attitude
Commitment to Competence	Empowerment	Openness

Shared values and believes	Leadership	Expectations
Employee motivation	Integrity	

Instructions

This questionnaire is comprised of several definitive statements that relate to soft control. Please indicate your opinion towards each statement made. After you have competed the questionnaire, you are pleased to return this anonymous questionnaire to ?????? on or before ????????, please be advised that all information will be handled discreetly.

There are 5 score degrees from 1 to 5, as follows: “5” means I strongly agree, “4” means I agree, “3” means I’m neutral, “2” means I disagree, while “1” means I strongly disagree, in addition please tick mark the appropriate fields in the demographic section below, this helps assuring the reliability of results:

Subject Matter		**X**	**Subject Matter**		**X**
Academic Background	Less than Bachelor’s degree		**Total years of experience**	< 5	
				5 – 10	
	Bachelor’s degree			11 – 15	
	Master degree			16 – 20	
	PHD			> 20	
Specialization Field	Accounting		**Years of experience in the current position**	< 5	
	Business administration			5 – 10	
	Finance			11 – 15	
	Banking			16 – 20	
	Other, specify:			> 20	
Professional Background	CPA		**Nature of work**	Board member	
				Executive manager	
	CIA			Internal control specialist	
	Any risk management Certificate			Risk management specialist	
	CFE			Internal auditor	
	CICS			Operations	
	Other, specify:			Other, specify:	
Bank nationality	Domestic bank		**Have a hybrid experience in:**	More than one bank	
	Foreign bank			Mix of domestic and foreign banks	
I’m treating corporate governance matters?			**I’m a member of an audit / risk management committee?**		
I’m a member of internal control related committee (s), Specify:			**I never participated in any committee whatever its role**		

Subject Matter	X	Subject Matter	X
I did work as internal auditor		**I appreciate the internal control role**	

Best Regards,

Student Researcher: Tarek Ruhmi

Professor Supervisor: Michel Suwaidan, Head-Accounting Department

Seq.	Question	Ranking from S. agree (5) to S. disagree (1)				
		5	4	3	2	1
Awareness and acting						
1	To what extent do you consider the following to play a role as a soft control?					
	- People's integrity and ethical values					
	- Management's philosophy and operating style					
	- Approvals/Authority Levels					
	- Segregation of duties					
	- Reconciliations					
	- Performing control self assessment					
	- Responsibility and accountability					
	- Commitment to competence					
2	Information on soft controls is communicated effectively and clearly both up and down within my department and across other areas					
3	My company's code of conduct and other policies regarding acceptable business practice, conflicts of interest, and expected ethical standards of ethical and moral behavior are comprehensive and relevant and address matters of significance to me					
4	Employees in my department fully and clearly understand what behavior is acceptable and unacceptable under the bank's Code of Conduct and know what to do when they encounter improper behavior					
5	Soft controls are an integral part of the dominate culture in my bank					
6	Outside parties understand my bank's ethical and behavioral standards and the ethical behavior basis on which my bank expects those parties to execute their deals with it					
7	In my bank, internal auditors and risk people assess employees' understanding and compliance with soft controls by holding interviews with them, by observation, or through questionnaires or any other relevant methods					
8	I think my bank's core beliefs are just words people use					
9	The level of integrity of people in my department is getting better overtime					
10	My organization's reputation in my community is remaining steady					
Recognition of importance						
11	I believe that any failure in the functionality of "soft" controls are the root causes of the subsequent failure in "hard" controls					
12	Top management frequently communicates the importance of soft controls such as integrity and ethical behavior by all possible means					
13	My bank emphasizes soft controls when it comes to directly investigate cases of fraud and occupational abuse					
14	Top management thinks soft controls are real controls, and it heavily relies on them					
15	Employees in my department understand what behavior is acceptable and what behavior is considered unacceptable					
16	Employees in my department know what to do when they encounter improper behavior given the importance of ethical behavior					
17	In my opinion, managers and employees in my bank show high level of commitment to competence, and they demonstrate that by having the adequate knowledge, competence, experience and training necessary to fulfill their assigned responsibilities					

Seq.	Question	Ranking from S. agree (5) to S. disagree (1)				
		5	4	3	2	1
18	As the attitude of management toward risk is part of soft controls aspects and it sums up its operational philosophy. Managers in my bank move carefully, proceeding only after analyzing the risks and potential benefits of ventures					
19	Top management's commitment to integrity and ethical behavior in its day-to-day activities is essential for the effective implementation of internal control system across the bank					
20	The existence of the bank's Code of Conduct and the consequences of its breach are an effective deterrent to unethical behavior					
Control implementation						
21	In my department, people usually implement appropriately soft controls					
22	if your answer to the previous question was "I strongly agree" or "I agree", please answer the following question: Does implementation of soft controls started after the request of senior management and/or the board of directors?					
23	Managers at all levels do not ignore any sign of inappropriate behavior, on the contrary, they take it seriously					
24	My bank adopts and promotes a culture of integrity, including ethics, business practices and human resources evaluations					
25	Soft control procedures described in policy and procedure manuals are actually applied the way they are intended to be applied and relate clearly to identified risks					
26	Mechanisms exist to effectively collect and investigate information related to soft controls like business ethical issues					
27	Management at all levels strictly prohibits circumvention of established policies and procedures, and demonstrates commitment to this principle					
28	Internal auditors do audit soft controls as part of their planned audit program, and they have specified audit tools for that purpose					
29	In the last 3 years, my bank has implemented inclusively and/or partially certain strategies in relation to one of the following soft control topics: focus on core values, errors handling policy, employee empowerment, self-directed work teams, transparency related issues					
30	In my bank, any violation to the code of conduct is being reported through predefined channels e.g. hot-line					
31	Performance appraisals adequately address the adherence to soft controls, and set forth criteria for integrity and ethical behavior					
32	My bank's business ethics are for appearances only					
33	In the event of known soft control breaches or deficiencies, appropriate and timely actions are being taken on such breaches					
34	In my knowledge, good employee suggestions are acknowledged by providing incentives or other meaningful recognition					
35	Top management is receptive to comments by internal and external auditors regarding control deficiencies or suggestions for process improvement.					
36	As a result of the positive attitude of management in the previous question, appropriate actions are being taken and documented					
37	Evaluations of soft controls (environmental controls) are only performed when there are major strategy changes, new operations and/or processes have been					

Seq.	Question	Ranking from S. agree (5) to S. disagree (1)				
		5	4	3	2	1
	adopted or changed					
38	In my department, management takes the appropriate disciplinary actions in response to departures from approved policies and procedures or violations of the code of conduct					
39	Deficiencies in soft controls are identified by on-going and separate monitoring activities of the bank					
limitations and hindrances						
40	Top management rarely addresses and resolves violations of behavioral and ethical standards consistently, timely, and equitably in accordance with the provisions of the Bank's Code of Conduct					
41	In my knowledge, management in general lacks the requisite commitment to integrity and ethical behavior					
42	I usually receive this message from my management, "Do your job and achieve your objective, I do not know how, just do it"					
43	Employees face pressures to cut corners, consequently they could not generally be inclined to do the "right thing"					
44	Neither the existence of the code of conduct or its absence makes difference, in fact I cannot say that the code of conduct in my bank represents an effective deterrent to unethical behavior					
45	My management does not have the specialized knowledge, experience, and training required to perform properly its duties at highest professional levels					
46	There is a lack of adequate supervision from the audit/risk management committee (s) to all internal control and audit activities					
47	Audit and/or risk management committee (s) rarely meets privately with the internal and external auditors and the risk people to discuss any aspect of weakness that might prevent the effective implementation of internal control system					
48	In my knowledge, there is insufficient involvement to the board and audit committee in evaluating the effectiveness of the "tone at the top" and taking steps to ensure its appropriateness					
49	I do not believe that my management considers what I do in terms of "adding value" to the bank's overall strategy					
50	The communication channels in my bank are not clear and transparent enough to report suspected improprieties related to the bank's business ethics					
51	I believe that persons who reports on such a suspected behaviors and/or improprieties are not protected enough against any reprisal actions					
52	I believe there is lots to do in order to improve the status of soft control in my workplace					

Appendix 7

The Multiple Regression Working Assumptions

Item	Criteria
Sample size	Tabachnick and Fidell (2001, p. 117) give a formula for calculating sample size requirements, taking into account the number of independent variables that you wish to use: N > 50 + 8m (where m = number of independent variables).
Multicollinearity	As per Tabachnick and Fidell (2001, p. 84) suggest that you 'think carefully before including two variables with a bivariate correlation of, say, .7 or more in the same analysis'. Detecting multicollinearity problems is done through inspecting the following from the SPSS table labeled coefficients: Two values are given: Tolerance and VIF. Tolerance is an indicator of how much of the variability of the specified independent is not explained by the other independent variables in the model and is calculated using the formula 1–R2 for each variable. If this value is very small (less than .10), it indicates that the multiple correlation with other variables is high, suggesting the possibility of multicollinearity. The other value given is the VIF (Variance inflation factor), which is just the inverse of the Tolerance value (1 divided by Tolerance). VIF values above 10 would be a concern here, indicating multicollinearity.
singularity	Singularity occurs when one independent variable is actually a combination of other independent variables. There should not be a singularity cases.
Outliers, Normality, Linearity, Homoscedasticity, Independence of Residuals	One of the ways that these assumptions can be checked is by inspecting the residuals scatter-plot and the Normal Probability Plot of the regression standardized residuals that were requested as part of the analysis. - In the Normal Probability Plot you are hoping that your points will lie in a reasonably straight diagonal line from bottom left to top right. *This would suggest no major deviations from normality*. - In the Scatter-plot of the standardized residuals we are hoping that the residuals will be roughly rectangularly distributed, with most of the scores concentrated in the centre (along the 0 point). *Deviations from a centralized rectangle suggest some violation of the assumptions*. - The presence of *outliers* can also be detected from the **Scatter-plot**. Tabachnick and Fidell (2001) define outliers as cases that have a standardized residual (as displayed in the scatter-plot) of more than 3.3 or less than –3.3. With large samples, *it is not uncommon to find a number of outlying residuals*. - Information concerning *unusual* cases is found in the Table titled **Casewise Diagnostics**. This presents information about cases that have standardized residual values above 3.0 or below –3.0. In a *normally distributed sample* we would expect only 1% of cases to fall outside this range. In this case the model did not clearly

Item	Criteria
	predict this person’s score very well. - To check whether this strange case is having any undue influence on the results for our model as a whole, we can check the value for **Cook’s Distance** given towards the bottom of the **Residuals Statistics** table. According to Tabachnick and Fidell (2001, p. 69), cases with values larger than 1 are a potential problem.

Appendix 8

The T-Test Working Assumptions

- Level of measurement – dependent variable is measured at the interval or ratio level.
- Random sampling – scores are obtained using a random sample from the population.
- Independence of observations – observations that make up the data must be independent of one another.
- Normal distribution – It is assumed that the populations from which the samples are taken are normally distributed.
- Homogeneity of variance – Techniques here make the assumption that samples are obtained from populations of equal variances. This means that the variability of scores for each of the groups is similar. To test this, SPSS performs the Levene test for equality of variances as part of the t-test and analysis of variances analyses. Homogeneity is being obtained if the test is significant (greater than 0.05).
- Significance level of Levene's test greater than 0.05, that means equal variances assumed.
- From Sig. (2-tailed), if the value is *above* .05, there is no significant difference between the two groups. This means that we can conclude that there is *not* a statistically significant difference in the mean "dependent variable" scores for "the independent variable".

Once this is done we want to check out how much is the magnitude of differences because of the effect of the size of the sample and that did not happen by chance. The following eta square equation is being used for this purpose: $\frac{t^2}{t2+(N1+N2-2)}$, I also adopted the guidelines (proposed by Cohen, 1988) for interpreting this value are:
.01 = small effect,
.06 = moderate effect,
.14 = large effect.

ملخص

توجهت هذه الدراسة إلى تغطية اثر الرقابة الناعمة على كفاءة تطبيق أنظمة الرقابة الداخلية، وتهدف هذه الدارسة إلى التحقق من مستوى الوعي بالرقابة الناعمة والوقوف عند أهميتها لمفردات العينة محل الدراسة ومدى تطبيق مفاهيمها لديهم وفي النهاية للتحري عن أية معوقات تحول دون التطبيق السليم للرقابة الناعمة.

ويقصد بالرقابة الناعمة تلك الرقابة غير الملموسة التي توجه سلوك الأفراد في المؤسسات نحو تحقيق الأهداف ومن الأمثلة على الرقابة الناعمة: أخلاقيات العمل، الالتزام تجاه الكفاءة، نمط الإدارة التشغيلي

وللوصول إلى تحقيق هذه الأهداف فقد تم تطوير وتوزيع استبيان بهدف جمع البيانات اللازمة بهدف إجراء التحليلات اللازمة لاحقا، وتميز الدراسة نفسها ضمن المحورين التاليين: أولا إنها تقدم تغطية شاملة للرقابة الناعمة تتراوح بين التعريف بالرقابة الناعمة (غير الرسمية) إلى بيان العلاقة بينها وبين الرقابة الخشنة (الرسمية) وبين خصائص المؤسسة التي تطبق ضمنها الرقابة الناعمة ثم تمتد إلى دراسة المخاطر الناعمة وصولا إلى دراسة علاقة الرقابة الناعمة مع الحاكمية المؤسسية. ثانيا تقدم الدراسة تحليلات مفصلة للارتباط والارتباط الجزئي بين متغيرات الدراسة كما أنها سعت إلى دراسة حالات الاختلاف بين مجموعات الدراسة حيال بعض الأمور الرقابية إضافة إلى دراسة معامل الانحدار الذي يدلل على قوة التوقع في علاقة الحصول بين المتغيرات.

وقد توصلت الدراسة إلى نتيجة مفادها أن مستوى تطبيق الرقابة الناعمة لدى المؤسسات المصرفية العاملة في الأردن مرضي باستثناء بعض نقاط النقاش المتعلقة ببذل مزيد من الجهد ضمن نواحي التدريب وتعزيز الشفافية وإطلاق روح المبادرة الشخصية الخلاقة بما يتعلق بتطبيق الرقابة إضافة إلى تصويب وضع بعض المعوقات التي تحول دون التطبيق الكفء ومن ثم المناداة بان يكون للبنك المركزي الأردني دور في عملية تطبيق الرقابة الناعمة.